

AXIAL VECTOR ENGINE CORP
Form 10QSB
February 21, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 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: December 31, 2005

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

For the transition period _____ to _____

Commission File Number: 000-49698

Axial Vector Engine Corporation

(Exact name of small business issuer as specified in its charter)

Nevada

(State or other jurisdiction of incorporation or organization)

20-3362479

(IRS Employer Identification No.)

One World Trade Center
121 S.W. Salmon Street, Suite 1100
Portland, Oregon 97204

(Address of principal executive offices)

503-471-1348

(Issuer's telephone number)

(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) 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 issuer 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 shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:
33,713,166 Common Shares as of December 31, 2005

Transitional Small Business Disclosure Format (check one): Yes No

Table of Contents

<u>TABLE OF CONTENTS</u>		<u>Page</u>
<u>PART I - FINANCIAL INFORMATION</u>		
Item 1:	<u>Financial Statements</u>	3
Item 2:	<u>Plan of Operation</u>	4
Item 3:	<u>Controls and Procedures</u>	8
<u>PART II - OTHER INFORMATION</u>		
Item 1:	<u>Legal Proceedings</u>	10
Item 2:	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	10
Item 3:	<u>Defaults Upon Senior Securities</u>	11
Item 4:	<u>Submission of Matters to a Vote of Security Holders</u>	11
Item 5:	<u>Other Information</u>	11
Item 6:	<u>Exhibits</u>	12

Table of Contents

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Our unaudited condensed consolidated financial statements included in this Form 10-QSB are as follows:

- (a) Unaudited Condensed Consolidated Balance Sheet as of December 31, 2005. F-1
- (b) Unaudited Condensed Consolidated Statements of Operations for the six and F-2
three months
ended December 31, 2005 and 2004;
- (c) Unaudited Condensed Consolidated Statements of Cash Flows for the six F-3
months
ended December 31, 2005 and 2004; and
- (d) Notes to Unaudited Condensed Consolidated Financial Statements F-4

These unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the SEC instructions to Form 10-QSB. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the interim period ended December 31, 2005 are not necessarily indicative of the results that can be expected for the full year.

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY KNOWN AS AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY) CONDENSED
CONSOLIDATED BALANCE SHEET
DECEMBER 31, 2005 (UNAUDITED)**

<u>ASSETS</u>	2005
Current Assets:	
Cash and cash equivalents	\$ 43,846
Deposit	22,670
Prepaid expenses	455,871
Total Current assets	522,387
Property and equipment, net	37,080
Intangible assets, net	243,324
TOTAL ASSETS	\$ 802,791
<u>LIABILITIES AND STOCKHOLDERS' DEFICIT</u>	
LIABILITIES	
Current Liabilities:	
Accounts payable and accrued expenses	\$ 709,414
Note payable	2,995,000
Liabiltiy for stock to be issued	283,845
Payroll liabilities	11,823
Due to related company	301,339
Total Current liabilities	4,301,421
Long Term Liabilities:	
Due to shareholders	1,214,222
Total long term liabilities	1,214,222
Total Liabilities	5,515,643
COMMITMENTS AND CONTINGENCIES	
-	
STOCKHOLDERS' DEFICIT	
Preferred stock, \$.001 Par Value; 100,000,000 shares authorized no shares issued and outstanding	-
Common stock, \$.001 Par Value; 100,000,000 shares authorized 33,713,166 shares issued and outstanding	33,713
Additional paid-in capital	15,532,678
Deficit accumulated during the development stage	(20,279,243)

Total Stockholders' Deficit	(4,712,852)
------------------------------------	-------------

TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	\$ 802,791
--	------------

The accompanying notes are an integral part of the consensed consolidated financial statements.

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY KNOWN AS AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE SIX AND THREE MONTHS ENDED DECEMBER 31, 2005 AND 2004 (UNAUDITED)
WITH CUMULATIVE TOTALS SINCE INCEPTION**

	SIX MONTHS ENDED		THREE MONTHS ENDED		CUMULATIVE TOTALS DECEMBER 30, 2002 through DECEMBER 31, 2005
	DECEMBER 31		DECEMBER 31		
	2005	2004	2005	2004	
OPERATING REVENUES					
Sales	\$ -	\$ -	\$ -	\$ -	-
COST OF SALES					
	-	-	-	-	-
GROSS PROFIT					
	-	-	-	-	-
OPERATING EXPENSES					
Compensation expense	108,020	-	78,958	-	2,854,486
Professional and consulting fees	658,879	174,500	431,716	82,000	6,376,010
Advertising and promotions	116,438	-	73,588	-	325,515
Rent	8,368	-	7,369	-	52,544
Impairment of property and equipment	-	-	-	-	107,964
Impairment of goodwill and intangibles	-	812,500	-	-	4,563,847
Write-off of inventory	-	-	-	-	266,519
Research and development	2,239,211	-	1,023,360	-	4,570,371
General and administrative expenses	270,514	40,062	173,934	24,562	1,079,128
Depreciation and amortization	3,634	287	2,082	287	44,328
Total Operating Expenses	3,405,064	1,027,349	1,791,007	106,849	20,240,712
NET LOSS BEFORE OTHER (EXPENSES) AND PROVISION FOR INCOME TAXES					
	(3,405,064)	(1,027,349)	(1,791,007)	(106,849)	(20,240,712)

OTHER (EXPENSES)					
Interest income	71	-	6	-	7,749
Interest expense	(29,150)	(3,351)	(13,829)	(1,851)	(46,280)
Total Other Expenses	(29,079)	(3,351)	(13,823)	(1,851)	(38,531)
NET LOSS BEFORE PROVISION FOR INCOME TAXES					
	(3,434,143)	(1,030,700)	(1,804,830)	(108,700)	(20,279,243)
Provision for income taxes	-	-	-	-	-
NET LOSS	\$ (3,434,143)	\$ (1,030,700)	\$ (1,804,830)	\$ (108,700)	\$ (20,279,243)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING					
	32,817,555	19,764,859	33,188,833	28,234,413	
NET LOSS PER COMMON SHARE OUTSTANDING					
	\$ (0.1046)	\$ (0.0521)	\$ (0.0544)	\$ (0.0038)	

The accompanying notes are an integral part of the consensed consolidated financial statements.

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY KNOWN AS AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX AND THREE MONTHS ENDED DECEMBER 31, 2005 AND 2004 (UNAUDITED)
(WITH CUMULATIVE TOTALS SINCE INCEPTION)**

	2005	2004	Cumulative Totals December 30, 2002 through December 31, 2005
CASH FLOWS FROM OPERATING ACTIVITIES			
Net loss	(3,434,143) \$	(1,030,700) \$	(20,279,243)
Adjustments to reconcile net loss to net cash used in operating activities			
Common stock issued for services	529,600	109,000	4,681,139
Common stock issued as compensation	-	-	1,200,000
Options issued for services	-	-	2,069,961
Options issued as compensation	22,750	-	1,102,750
Depreciation and amortization	3,634	287	44,328
Impairment of property and equipment	-	-	107,964
Impairment of goodwill and intangibles	-	812,500	4,563,847
Impairment of inventory	-	3,351.00	266,519
Changes in assets and liabilities			
Decrease (Increase) in prepaid expenses and other current assets	(433,541)	-	(455,272)
Increase in accounts payable and accrued expenses	577,995	2,998,351	765,720
Increase in payroll liabilities	11,823	-	11,823
Total adjustments	712,261	3,923,489	14,358,779
Net cash (used in) operating activities	(2,721,882)	2,892,789	(5,920,464)
CASH FLOWS FROM INVESTING ACTIVITIES			
Acquisition of business	-	-	(1,018,814)
Acquisitions of intangible assets	(179,574)	-	(243,324)
Acquisitions of fixed assets	(19,572)	(3,011,743)	(69,335)
Net cash (used in) investing activities	(199,146)	(3,011,743)	(1,331,473)

CASH FLOWS FROM FINANCING ACTIVITIES			
Issuance of stock through the exercise of options	50,079	-	50,079
Proceeds from the sale of stock	-	-	1,648,048
Proceeds from Standby Equity Distribution Agreement	3,350,000	-	3,750,000
Liability for stock to be issued	(400,000)	-	337,095
Repayment of loan	-	-	(5,000)
Advances from shareholders	-	124,723	1,700,711
Payments to shareholders	(32,565)	-	(486,489)
Payments to related company	(10,000)	-	(13,000)
Advances from related company	-	-	314,339
Net cash provided by financing activities	2,957,514	124,723	7,295,783
NET INCREASE IN CASH AND CASH EQUIVALENTS			
	36,486	5,769	43,846
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR			
	7,360	-	-
CASH AND CASH EQUIVALENTS - END OF YEAR			
	\$ 43,846	\$ 5,769	\$ 43,846
SUPPLEMENTAL CASH FLOW INFORMATION			
Cash paid during the year for interest	\$ -	\$ -	\$ 190
SUPPLEMENTAL DISCLOSURE OF NONCASH INFORMATION			
Common stock issued for services	\$ 529,600	\$ 109,000	\$ 4,681,139
Impairment of property and equipment	\$ -	\$ -	\$ 107,964
Impairment of goodwill and intangibles	\$ -	\$ 812,500	\$ 1,513,847
Impairment of inventory	\$ -	\$ -	\$ 266,519
Conversion of payables to equity	\$ 53,250	\$ -	\$ 170,285

The accompanying notes are an integral part of the consensed consolidated financial statements.

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(UNAUDITED)**

NOTE 1 - ORGANIZATION AND BASIS OF PRESENTATION

The condensed consolidated unaudited interim financial statements included herein have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). The condensed consolidated financial statements and notes are presented as permitted on Form 10-QSB and do not contain information included in the Company's annual statements and notes. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. It is suggested that these condensed financial statements be read in conjunction with the June 30, 2005 audited financial statements and the accompanying notes thereto. While management believes the procedures followed in preparing these condensed financial statements are reasonable, the accuracy of the amounts are in some respects dependent upon the facts that will exist, and procedures that will be accomplished by the Company later in the year.

These condensed consolidated unaudited financial statements reflect all adjustments, including normal recurring adjustments which, in the opinion of management, are necessary to present fairly the operations and cash flows for the periods presented.

Princeton Ventures, Inc. (the "Company") was incorporated in the State of Nevada on May 10, 2001. The Company had not commenced operations. On May 30, 2003, the Company exchanged 37,994,923 shares of its common stock for all of the issued and outstanding shares of Aero Marine Engine Corp. ("Aero"). Aero was formed on December 30, 2002. Aero had no operations and was formed to acquire the assets of Dyna-Cam Engine Corporation. The Company changed its name from Princeton Ventures, Inc. to Aero Marine Engine, Inc.

At the time that the transaction was agreed to, the Company had 20,337,860 common shares issued and outstanding. In contemplation of the transaction with Aero, the Company's two primary shareholders cancelled 9,337,860 shares of the Company's common stock held by them, leaving 11,000,000 shares issued and outstanding. As a result of the acquisition of Aero, there were 48,994,923 common shares outstanding, and the former Aero stockholders held approximately 78% of the

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(UNAUDITED)**

**NOTE 1 - ORGANIZATION AND BASIS OF PRESENTATION
(CONTINUED)**

Company's voting stock. For financial accounting purposes, the acquisition was a reverse acquisition of the Company by Aero, under the purchase method of accounting, and was treated as a recapitalization with Aero as the acquirer. Accordingly, the historical financial statements have been restated after giving effect to the May 30, 2003, acquisition of the Company. The financial statements have been prepared to give retroactive effect to December 30, 2002, the date of inception of Aero, of the reverse acquisition completed on May 30, 2003, and represent the operations of Aero. Consistent with reverse acquisition accounting: (i) all of Aero's assets, liabilities, and accumulated deficit, are reflected at their combined historical cost (as the accounting acquirer) and (ii) the preexisting outstanding shares of the Company (the accounting acquiree) are reflected at their net asset value as if issued on May 30, 2003.

Additionally, on June 30, 2003, the Company acquired the operating assets of Dyna-Cam Engine Corp. ("Dyna-Cam"). Dyna-Cam was a development stage enterprise developing a unique, axial cam-drive, free piston, internal combustion engine. Dyna-Cam intended to produce and sell the engine primarily for aircraft and marine applications. Dyna-Cam had not generated significant revenues at the time of the Company's acquisition.

The Company, under its new management, has raised over \$1,200,000 in cash to affect the development of the Axial Vector Engine "E" (Electronic). Management believes that significant capital is required to adequately develop the Axial Vector Engine "E" engine and begin operations. For the three months ended September 30, 2005, shareholders of the Company have advanced a net of \$493,404 to assist in funding the operations.

The Company will require additional capital. Although the current majority stockholders of the Company, as well as an affiliate, have made verbal commitments with no guarantees to continue to fund the development and sales and marketing efforts of the Company, if alternate financing cannot be obtained. There can be no assurance that any new

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(UNAUDITED)**

**NOTE 1 - ORGANIZATION AND BASIS OF PRESENTATION
(CONTINUED)**

capital would be available to the Company or that adequate funds for the Company's operations, whether from the Company's revenues, financial markets, or other arrangements will be available when needed or on terms satisfactory to the Company. The failure of the Company to obtain adequate additional financing will require the Company to delay, curtail or scale back some or all of its research and development programs, sales, marketing efforts and manufacturing operations.

On May 19, 2005, the Company announced that it had changed its name to Axial Vector Engine Corporation ("Axial"). Management believes the new name will more accurately describe the Company's mission. The Company's stock symbol changed to AXVC.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents consists principally of currency on hand, demand deposits at commercial banks, and liquid investment funds having an original maturity of three months or less at the time of purchase.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to credit risk consist of cash equivalents and accounts receivable.

The Company's policy is to review the amount of credit exposure to any one financial institution and place investments with financial institutions evaluated as being creditworthy. In the ordinary course of business, the Company has bank deposits that may exceed federally insured limits. As of December 31, 2005, the Company was not in excess of the \$100,000 insured limit.

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(UNAUDITED)**

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiary Dyna-Cam, Aero Marine Engine Corp. All significant inter-company accounts and transactions are eliminated.

Property and Equipment

Property and equipment is stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, three to seven years. Reviews are regularly performed to determine whether facts and circumstances exist that indicate the carrying amount of assets may not be recoverable or the useful life is shorter than originally estimated. The Company assesses the recoverability of its property and equipment by comparing the projected undiscounted net cash flows associated with the related asset or group of assets over their remaining lives against their respective carrying amounts. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets.

If assets are determined to be recoverable, but the useful lives are shorter than originally estimated, the net book value of the assets is depreciated over the newly determined remaining useful lives. When equipment is retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and the resulting gain or loss is included in operations.

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(UNAUDITED)**

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Reclassifications

Certain amounts for the six months ended December 30, 2004 have been reclassified to conform to the presentation of the December 31, 2005 amounts. The reclassifications have no effect on net loss for the six months ended December 31, 2004.

Income Taxes

The Company has adopted the provisions of Statement of Financial Accounting Standards (“SFAS”) No. 109, Accounting for Income Taxes. The Statement requires an asset and liability approach for financial accounting and reporting of income taxes, and the recognition of deferred tax assets and liabilities for the temporary differences between the financial reporting bases and tax bases of the Company’s assets and liabilities at enacted tax rates expected to be in effect when such amounts are realized or settled.

Advertising

The Company’s policy is to expense the costs of advertising and marketing as they are incurred. Advertising expense for the six months ended December 31, 2005 and 2004 was \$116,438 and \$0, respectively.

Research and Development

Research and development costs are expensed as incurred.

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(UNAUDITED)**

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Intangible Assets

Intangible assets are comprised of goodwill, and the technology and intellectual property of Transporter, Inc., as well as new patents pending related to the Axial Vector Engine "E" (Electronic). These assets represent the value of the difference between the purchase price of the acquired business and the fair value of the identifiable tangible net assets. The Company adopted Statement of Financial Accounting Standard ("SFAS") No. 142, Goodwill and Other Intangible Assets. The Company does not amortize goodwill, but rather annually evaluates the carrying value of goodwill for impairment, in accordance with the provisions of SFAS No. 142. The finite life of the intangibles will be amortized over 17 years when final approval is granted. Amortization expense was \$ -0- for the six months ended December 31, 2005

The Company recognized impairment of the intangible asset of \$-0- and \$812,500 for the six months ended December 31, 2005 and 2004, respectively.

During the six months ended December 31, 2005, the Company incurred costs of \$179,574 in applying and registering of patents. These patents are currently pending. Due to the nature of the patents, the Company anticipates receiving confirmation on their applications in an expedited fashion.

Start-up Costs

In accordance with the American Institute of Certified Public Accountants Statement of Position 98-5, "*Reporting on the costs of Start-up Activities*", the Company expenses all costs incurred in connection with the start-up and organization of the Company.

Stock-Based Compensation

Employee stock awards under the Company's compensation plans are accounted for in accordance with Accounting Principles Board Opinion No. 25 ("APB 25"), "*Accounting for Stock Issued to Employees*", and related interpretations. The Company provides the disclosure requirements of Statement of Financial Accounting Standards No. 123, "*Accounting for*

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(UNAUDITED)**

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Stock-Based Compensation (Continued)

Stock-Based Compensation” (“SFAS 123”), and related interpretations. Stock-based awards to non-employees are accounted for under the provisions of SFAS 123 and has adopted the enhanced disclosure provisions of SFAS No. 148 “Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of SFAS No. 123”.

The Company measures compensation expense for its employee stock-based compensation using the intrinsic-value method. Under the intrinsic-value method of accounting for stock-based compensation, when the exercise price of options granted to employees is less than the estimated fair value of the underlying stock on the date of grant, deferred compensation is recognized and is amortized to compensation expense over the applicable vesting period. In each of the periods presented, the vesting period was the period in which the options were granted.

The Company measures compensation expense for its non-employee stock-based compensation under the Financial Accounting Standards Board (FASB) Emerging Issues Task Force (EITF) Issue No. 96-18, “*Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring or in Conjunction with Selling, Goods or Services*”. The fair value of the option issued is used to measure the transaction, as this is more reliable than the fair value of the services received. The fair value is measured at the value of the Company’s common stock on the date that the commitment for performance by the counterparty has been reached or the counterparty’s performance is complete. The fair value of the equity instrument is charged directly to compensation expense and additional paid-in capital.

Common Stock Issued for Other Than Cash

Services purchased and other transactions settled in the Company’s common stock are recorded at the estimated fair value of the stock issued if that value is more readily determinable than the fair value of the consideration received.

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(UNAUDITED)**

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

(Loss) Per Share of Common Stock

Historical net income (loss) per common share is computed using the weighted average number of common shares outstanding. Diluted earnings per share (EPS) include additional dilution from common stock equivalents, such as stock issuable pursuant to the exercise of stock options and warrants. Common stock equivalents are not included in the computation of diluted earnings per share when the Company reports a loss because to do so would be antidilutive for the periods presented.

The following is a reconciliation of the computation for basic and diluted EPS:

	December 31, 2005	2004
Net Income (Loss)	\$ (3,434,143)	\$ 594,300
Weighted-average common shares outstanding (Basic)	32,817,555	19,764,859
Weighted-average common stock equivalents:		
Stock options and warrants	-	-
Weighted-average common shares outstanding (Diluted)	32,817,555	19,764,859

Options and warrants outstanding to purchase stock were not included in the computation of diluted EPS because inclusion would have been antidilutive. As of December 31, 2005 there were 243,209 options and 250,004 warrants available. The warrants have the options to purchase 2,355,000 shares. As of December 31, 2004, there were no outstanding options or warrants available.

Fair Value of Financial Instruments

The carrying amount reported in the balance sheets for cash and cash equivalents and liability for stock to be issued approximate fair value because of the immediate or short-term maturity of these financial instruments.

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(UNAUDITED)**

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Recently Issued Accounting Pronouncements

On December 16, 2004, the Financial Accounting Standards Board ("FASB") published Statement of Financial Accounting Standards No. 123 (Revised 2004), Share-Based Payment ("SFAS 123R"). SFAS 123R requires that compensation cost related to share-based payment transactions be recognized in the financial statements. Share-based payment transactions within the scope of SFAS 123R include stock options, restricted stock plans, performance-based awards, stock appreciation rights, and employee share purchase plans. The provisions of SFAS 123R are effective for small business issuers as of the first interim period that begins after December 15, 2005. Accordingly, the Company will implement the revised standard January 1, 2006. Currently, the Company accounts for its share-based payment transactions under the provisions of APB 25, which does not necessarily require the recognition of compensation cost in the financial statements (note 3(d)). Management is assessing the implications of this revised standard, which may materially impact the Company's results of operations commencing January 1, 2006 and thereafter.

On December 16, 2004, FASB issued Statement of Financial Accounting Standards No. 153, Exchanges of Non-monetary Assets, an amendment of APB Opinion No. 29, Accounting for Non-monetary Transactions ("SFAS 153"). This statement amends APB Opinion 29 to eliminate the exception for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. Under SFAS 153, if a non-monetary exchange of similar productive assets meets a commercial-substance criterion and fair value is determinable, the transaction must be accounted for at fair value resulting in recognition of any gain or loss. SFAS 153 is effective for non-monetary transactions in fiscal periods that begin after June 15, 2005. The Company does not anticipate that the implementation of this standard will have a material impact on its financial position, results of operations or cash flows.

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(UNAUDITED)**

NOTE 3 - PROPERTY AND EQUIPMENT

Property and equipment consist of the following at December 31, 2005.

	2005
Computer	\$ 26,572
Equipment and machinery	13,274
Office equipment	2,723
	42,569
Less: accumulated depreciation	(5,489)
	\$ 37,080

Depreciation expense for the six months ended December 31, 2005 was \$3,634.

NOTE 4 - RELATED PARTY TRANSACTIONS

An affiliated entity provided office space to the Company at no charge, and funded payroll, moving and other general expenses. As of December 31, 2005, the Company incurred and accrued \$301,339, in liabilities to this entity. The advances and funding are based on verbal commitments with no guarantees of future advances or funding.

NOTE 5 - DUE TO SHAREHOLDERS

Certain shareholders of the Company have advanced funds to the Company to cover cash flow deficiencies. These advances have no stated repayment terms and bear interest at 5% with interest payable annually.

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(UNAUDITED)**

NOTE 6 - LIABILITY FOR STOCK TO BE ISSUED

This account represents shares to be issued in connection to a private investor for which cash was received by the Company prior to issuance of the stock as of December 31, 2005.

NOTE 7 - NOTE PAYABLE

Note payable to Transporter Inc. commencing August 2004 for the purchase of exclusive rights to certain video-conferencing technology. The Company is currently in litigation with Transporter Inc. regarding the technology for which the note was issued. The Company has defaulted on this note and this note is due in full. See Note 12 regarding the litigation of this matter.

NOTE 8 - PROVISION FOR INCOME TAXES

Deferred income taxes will be determined using the liability method for the temporary differences between the financial reporting basis and income tax basis of the Company's assets and liabilities. Deferred income taxes will be measured based on the tax rates expected to be in effect when the temporary differences are included in the Company's tax return. Deferred tax assets and liabilities are recognized based on anticipated future tax consequences attributable to differences between financial statement carrying amounts of assets and liabilities and their respective tax bases.

At December 31, 2005, deferred tax assets consist of the following:

		2005
Deferred tax assets	\$	6,902,000
Less: valuation allowance		(6,902,000)
Net deferred assets	\$	-0-

At December 31, 2005, the Company had federal net operating loss carry forwards in the approximate amounts of \$20,300,000 available to offset future taxable income through 2024. The Company established valuation allowances equal to the full amount of the deferred tax assets due to the uncertainty of the utilization of the operating losses in future periods.

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(UNAUDITED)**

NOTE 9 - STANDBY EQUITY DISTRIBUTION AGREEMENT

On April 25, 2005, the Company entered into a Standby Equity Distribution Agreement (“Agreement”) with Alliance Capital Management. Under the agreement, the Company may issue and sell to Alliance Capital Management common stock for a total purchase price of up to \$4.0 million. The purchase price for the first payment is 200,000 shares. The remaining purchase price for the shares is equal to 75% of the market price, which is determined as the lowest volume weighted average price of the common stock during the ten trading days following the notice date. This calculation is mandated by the Agreement.

The amount of each advance is subject to an aggregate minimum advance of \$400,000 and payable on the 5th of each month commencing May 5, 2005 and continuing through February 5, 2006. Alliance Capital Management received, as additional consideration, one (1) warrant to purchase two million shares of common stock at a fixed rate of \$4.00 per share for a period of two years.

NOTE 10 - STOCKHOLDERS' EQUITY (DEFICIT)

The Company has 100,000,000 shares of common stock authorized, par value \$.001. As of December 31, 2005, the Company has 33,713,166 shares of common stock issued and outstanding.

The Company issued 37,994,923 shares of its common stock in connection with the acquisition of Aero Marine Engine Corp. Under reverse acquisition accounting, these shares are reflected as issued on the date of inception and valued at the book value of the net assets of as of the date of the transaction.

Aero was incorporated in contemplation of the reverse acquisition of the Company as well as the Dyna-Cam acquisition. A total of 38,994,923 common shares were issued in the reverse merger transaction. However, 1,000,000 of those shares were designated for the Dyna-Cam acquisition. (See Subsequent Event Footnote.) The Company raised \$1,218,598 as part of its initial capitalization. This capital was raised among four individuals in contemplation of their receiving the 37,994,923 shares of the Company's common stock in connection with the acquisition of Aero Marine Engine Corp. The value of the 1,000,000 shares issued in connection with the Dyna-Cam purchase was determined to be \$0.032 per

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(UNAUDITED)**

**NOTE 10 - STOCKHOLDERS' EQUITY (DEFICIT)
(CONTINUED)**

share, which is the price per share paid by the investors that acquired the 37,994,923 shares for cash.

In connection with the reverse acquisition transaction with Aero, the Company's two controlling shareholders at that time cancelled 9,337,860 shares of common stock held by them. Upon completion of this cancellation, the Company had 11,000,000 shares of common stock remaining outstanding prior to the reverse acquisition transaction.

In January 22, 2004, the Company issued 5,000,000 shares of its common stock in exchange for consulting services rendered to the Company pursuant to an S-8 registration statement. These shares were valued at \$3,350,000 (\$.67 per share), the fair value of the stock at the date of issuance.

On July 30, 2004 with an effective date of August 9, 2004 the Board of Directors adopted a resolution authorizing and approving a 100 to 1 reverse stock split and the new trading symbol of the company is AOME.

On August 24, 2004 International Equity Partners, SA purchased Transporter, Inc., a company developing video conferencing software allowing the creation of virtual private networks that are PC based, have no need to use servers or special equipment, and operate on any broadband connection. The purchase price was \$3,000,000, \$100,000 of which is payable within 60 days of the date of the Exclusive Purchase Agreement with the balance payable in intervals over 24 months. In addition, the former stockholders of Transporter, Inc. are to be issued 1,000,000 shares of the common stock of the Company.

At the end of a two-year period the shares are guaranteed to be worth at least \$2.00 per share, and, if worth less, additional shares of stock will then be issued to make up the difference. The value of the shares is \$50,000 (\$.05 per share).

On August 24, 2004 the Company acquired through an assignment by International Equity Partners, SA all rights, title, and interest in the aforesaid Exclusive Purchase Agreement in exchange for 25,000,000 shares of common stock of the Registrant. All certificates issued will bear the appropriate 2-year restrictive legend. The value of the issuance is \$812,500, which was the fair value of the stock at the date the transaction was negotiated.

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(UNAUDITED)**

**NOTE 10 - STOCKHOLDERS' EQUITY (DEFICIT)
(CONTINUED)**

On August 25, 2004, the Company entered into a Consulting Fee Agreement with Carlyle Financial Consulting Group, which will continue to provide consulting services for all of the Company's businesses and will also continue to coordinate prospective acquisitions in European countries and the Arabian Gulf. The consulting fee was negotiated for 1,400,000 shares of common stock, which the Company has registered with the Securities and Exchange Commission on Form S-8 Registration Statement under the Securities Act of 1933.

On September 9, 2004, the Company issued 200,000 shares of common stock of the Company in exchange for legal and professional services rendered and to be rendered.

On November 8, 2004 the Company issued 157,788 shares of common stock of the Company in exchange for consulting services rendered.

On November 11, 2004 the Company issued 463,776 shares of common stock of the Company in exchange for financial services. The services were never rendered and the shares were subsequently cancelled. These transactions have been retroactively restated back to the period ended December 31, 2004 to reflect the cancellation.

On January 3, 2005 the Company issued 100,000 shares of common stock with a par value of \$.001 for \$300 cash.

On April 6, 2005 the Company issued 50,000 shares of common stock of the Company in exchange for consulting services rendered.

In April 2005, the Company completed an offering of 1,125,811 shares of common stock par value \$.001 to eight purchasers at the price of \$0.50 per share. The total amount the Company received was \$562,901. Due to an administrative error, 106,500 of these shares were not issued to a single purchaser and these shares were later issued in November 2005.

On April 20, 2005, the Company completed an offering of 1,800,000 units at a price of \$0.50 per unit. Each unit consists of one share of common stock par value \$.001 and one warrant to purchase one share of common stock, exercisable for two years closing of the offering. The total amount the Company received was \$900,000. As of December 31, 2005, only 1,232,311 shares have been issued.

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(UNAUDITED)**

**NOTE 10 - STOCKHOLDERS' EQUITY (DEFICIT)
(CONTINUED)**

On April 17, 2005, the Company issued 1,465,000 shares of common stock of the Company in exchange for a management-consulting contract. The contract is for a period of five years and is estimated to be worth \$35,000 a year, totaling \$175,000.

On April 15, 2005, the Company issued 600,000 shares of common stock of the Company as compensation.

On April 15, 2005, the Company issued 20,000 shares of common stock of the Company as part of a previous agreement for consulting services rendered.

In June 2005, the Company issued 129,061 shares of common stock of the Company for legal services.

During the year, the Company cancelled 860,000 of founder shares, which had been restated back to the period ended June 30, 2003.

In August of 2005, the Company issued 1,465,000 shares of common stock in exchange for financial services. The services were never rendered and the shares were subsequently cancelled.

For the three months ended December 31, 2005, the Company issued 195,000 shares of common stock of the Company in exchange for consulting services rendered.

For the three months ended December 31, 2005, the Company granted an employee options to purchase 15,000 shares of its common stock exercisable for a period of ten years at the exercise price of \$2.15 per share.

For the six months ended December 31, 2005, the Company issued 32,730 shares of common stock through the exercise of options. The options carried a strike price of \$1.53.

For the six months ended December 31, 2005, the Company issued 1,241,174 shares of common stock as part of their Standby Equity Agreement (See Note 9)

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(UNAUDITED)**

**NOTE 10 - STOCKHOLDERS' EQUITY (DEFICIT)
(CONTINUED)**

The Company, at December 31, 2005, has 100,000,000 shares of preferred stock authorized and no shares issued and outstanding.

NOTE 11 - GOING CONCERN UNCERTAINTY

As shown in the accompanying financial statements, as is typical of companies going through the development stage, the Company incurred net losses for the years ended June 30, 2005 and 2004 and for the six months ended December 30, 2005. The Company is currently in the development stage, and there is no guarantee whether the Company will be able to generate enough revenue and/or raise capital to support current operations and generate anticipated sales. This raises substantial doubt about the Company's ability to continue as a going concern. Management believes that the Company's capital requirements will depend on many factors including the success of the Company's product development efforts. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

NOTE 12 - COMMITTEMENTS AND CONTINGENCIES

On August 24, 2004 the Company entered into a Joint Venture Agreement with Adaptive Propulsion Systems, LLC ("Adaptive"), a wholly owned subsidiary of Tacronics. Adaptive will provide 100% of the capital and labor to build military grade engines based on the Registrant's Dyna-Cam engine design. Adaptive will pay the Company a 20% gross royalty on all orders of the engines sold to the United States Government. The Company will have the rest of the world military market and all civilian commercial applications, and the Company will pay a five (5%) percent royalty on such orders to Adaptive. For the six months ended December 31, 2005 the Company has research and development costs of approximately \$2,239,000

In May 2005, the Company filed suit against Transporter, Inc and its principals, Daniel Werner and Craig Della Penna. The suit seeks to rescind the August 2004 agreement under which the Company acquired the exclusive rights to certain video-conferencing technology. The Company contends that the principals intentionally misrepresented the status and capabilities of the technology that was acquired under the original agreement. The case is pending litigation. The Company has determined that the technology is worthless, and thus has impaired the asset in its entirety as of December 31, 2005.

In October 2005, the Company entered into a business consulting agreement with Wexler Kronen Capital Associates. Wexler is to provide consulting and

Table of Contents

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY
(FORMERLY AERO MARINE ENGINE, INC.)
(A DEVELOPMENT STAGE COMPANY)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(UNAUDITED)**

**NOTE 12 - COMMITMENTS AND CONTINGENCIES
(CONTINUED)**

promotional services for a period of 12 months. The payment for these services is \$7,000 per month, 10,000 shares of restricted stock and 3 warrants. Each warrant is exercisable for 35,000 shares at various exercise prices. One for \$4.00, the second for \$4.50 and the third for \$5.00. The warrants expire October 2008.

In November 2005, the Company entered into a business consulting agreement with Redwood Consultants L.L.C. Redwood is to provide consulting services for a period of 12 months to the Company. As part of this agreement, the Company issued 50,000 restricted shares with an additional 50,000 shares to be issued March 9, 2006 and July 9, 2006. All 150,000 were issued at commencement of the agreement and have been recorded as a prepaid asset on a prorata basis. In addition, the company has granted warrants to purchase 250,000 shares at \$4.00 per share which expire November 2007.

Table of Contents

Item 2. Plan of Operation

Forward-Looking Statements

Historical results and trends should not be taken as indicative of future operations. Management's statements contained in this report that are not historical facts are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934 (the "Exchange Act"), as amended. Actual results may differ materially from those included in the forward-looking statements. The Company intends such forward-looking statements to be covered by the safe-harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and is including this statement for purposes of complying with those safe-harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are generally identifiable by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project," "prospects," or similar expressions. The Company's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse affect on the operations and future prospects of the Company on a consolidated basis include, but are not limited to: changes in economic conditions, legislative/regulatory changes, availability of capital, interest rates, competition, and generally accepted accounting principles. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Further information concerning the Company and its business, including additional factors that could materially affect the Company's financial results, is included herein and in the Company's other filings with the SEC.

Summary of Product Research and Development

Internal Combustion Engine

Joint Venture Agreement with Adaptive Propulsion Systems, LLC

To assist us with the testing of the engine and in-house trials, we entered into a joint venture agreement ("Agreement") with Adaptive Propulsion Systems, LLC ("Adaptive"). Adaptive is a subsidiary of Tactronics, Inc. Under the terms of the Agreement, Adaptive can utilize its expertise to modify the engine; however, we will have all rights to any patentable technology that emerges. The term of this agreement is 20 years unless revised by joint agreement of the parties.

Once the testing process is complete and the product is available for sale, Adaptive will provide all of the capital and labor required to build military grade engines using our Axial Vector design. The Agreement grants Adaptive the exclusive right to sell the Axial Vector internal combustion engine to the United States military and all militaries of NATO countries. The Agreement was later amended to expand the exclusive right granted to Adaptive to include the military of the United Arab Emirates. Adaptive will be obligated to pay us a royalty of 20% of the gross sales. For all commercial non-military sales of internal combustion engines we make utilizing the Axial Vector design, we will pay Adaptive a royalty of 5% of gross sales.

Table of Contents

During the testing with Adaptive, significant results affecting the design and composition of the Axial Vector engine emerged. Through this testing, we were able to construct the engine with different alloys that reduced the weight of our 205 horsepower Axial Vector engine from 98 lbs. to 65 lbs. Another significant breakthrough during our testing revealed that the Axial Vector engine was capable of maintaining its performance level while adjusting to various fuels and a different mixture of fuels. The design of the Axial Vector engine offers significantly reduced weight, size, emissions and maintenance while gaining vast increases in horsepower, torque and fuel economy.

On November 30, 2005, we selected the final engineering design for the prototypical Axial Vector engine ("prototypical engine"). We anticipate that the prototypical engine will be completed by the end of March 2006. We anticipate commencing beta testing on our prototypical engine initially at Adaptive's facilities in April 2006. Thereafter, we intend to conduct beta testing on our prototypical engine at several different global locations with varying climates and elevations commencing prior to the end of July 2006. Beta testing and data gathering will proceed for a period of at least 3 months. During this time we will also gather data to estimate the Mean Time to Failure ("MTF") of our prototypical engine. The planned MTF testing will consist of running the engine for 60 days and taking measurements of the engine components to estimate the wear at the conclusion of the test. This testing will provide us with an accurate gauge of the endurance of the engine and its specific components. Based upon the results of the MTF and beta testing, further modifications may be required.

Following the completion of all testing and modifications, we are planning to commence initial manufacturing of an engine utilizing the axial vector design no later than December 2006. In the expected event that we are successful in generating revenue from licensing our technology and/or product sales, we will seek to increase our manufacturing capacity.

In the event that the Axial Vector engine proves suitable for military and commercial use, we plan over the next twelve months to license our Axial Vector engine for a wide variety of applications presently performed by the conventional internal combustion engine. Specifically, we intend to license the manufacturing rights to our technology for specific applications in defined geographical areas.

Power Generators

Power Generation Agreement

We intend to build several models of generators that utilize our Axial Vector engine. We use the term Gen Sets to describe all models and sizes of generators we intend to develop and manufacture. We are seeking to develop a generator with a high power density Axial Flux design that has one-third of the volume and half the weight of the average generator. We anticipate that these generators will be utilized for a wide variety of applications including military, commercial, and residential uses. We entered into an agreement with Adaptive to assist us in the design, development, and manufacture power generators for a family of seven generators ranging from 7.5 kilowatt to 1 megawatt contingent upon our ability to secure financing. We paid Adaptive \$3,171,000 to complete the development of the engines for the proposed power generator product line.

Under the terms of this agreement, Adaptive can utilize its expertise to modify the power generator; however, we will have all rights to any patentable or proprietary technology that emerges. Adaptive will be obligated to pay us a royalty of 20% of the gross sales to the military. For all commercial non-military sales of power generator made utilizing the Axial Vector engine and generator design, we will pay Adaptive a royalty of 5% of gross sales. The term of this agreement is 20 years unless revised by joint agreement of the parties.

Table of Contents

On April 25, 2005, we completed a Financing Agreement in the amount of \$4,000,000 with Alliance Capital Management. Under the terms of this agreement, we receive \$400,000 dollars each month for ten months commencing in May of 2005. The monthly payments received are convertible in common stock and the amount of shares issued is determined based on 75% of the previous ten day trading average of the company prior to the issuance. This Financing Agreement satisfies the contingency set forth in our agreement with Adaptive.

The development process for these power generators commenced in the last quarter of the fiscal year ended June 30, 2005. Subsequent to the reporting period, we agreed to pay Adaptive approximately \$660,000 to retain personnel to improve the functionality of the Axial Flux design utilized in our Gen Sets. We anticipate that Adaptive will be able to comply with the terms of this agreement and complete the development of our prototypical 200 kW Axial Flux generator driven by a 352 HP Axial Vector Engine ("prototypical generator") prior to the end of March 2006. We anticipate commencing beta testing on our prototypical generator initially at Adaptive's facilities in April 2006. Thereafter, we intend to conduct beta testing at several different global locations with varying climates and elevations commencing prior to the end of July 2006. Beta testing and data gathering will proceed for a period of at least 3 months. During this time we will also conduct tests to estimate the Mean Time to Failure ("MTF") of our prototypical generator. The planned MTF testing will consist of running the generator for 60 days and taking measurements of its components to estimate the wear at the conclusion of the test. This testing will provide us with an accurate gauge of the endurance of the generator and its specific components. Based upon the results of the MTF and beta testing, further modifications may be required.

Initial commercial manufacturing production of the Gen Sets is planned to be carried out at Adaptive's facilities in December 2006. In the expected event that we are successful in generating revenue from licensing our technology and product sales, we will seek to increase our manufacturing capacity.

Purchase and Sale of Plant or Significant Equipment

To date, Adaptive has performed all of our research, testing, and product development. If we are successful in developing products for military and commercial use, we intend to license the manufacturing rights. As a result, we do not anticipate any purchase or sale of and equipment over the next twelve months.

Licenses

On September 10, 2005, we entered into a memorandum of understanding ("MOU") with Kirloskar Oil Engines Limited ("KOEL"), an Indian based manufacturer and engineering company. We are working toward the execution of a definite agreement with KOEL where we would grant KOEL the exclusive right to utilize our technology for non-automotive applications including tractor engines, loader engines, fork lift truck engines, and other farm and forestry applications. The execution of a definitive agreement is contingent upon completion of the parties due diligence which was anticipated to be occur in January 2006. The parties have extended the anticipated closing date of a definitive agreement to July 2006 in order to provide the senior managers from KOEL with an opportunity to conduct additional due diligence at beta test sites where further product testing will be ongoing. Pursuant to the terms of the MOU, KOEL placed \$1,000,000 into a segregated account which it controls and we have granted them a right of first refusal with respect to the right to utilize our technology for non-automotive applications including tractor engines, loader engines, fork lift truck engines, and other farm and forestry applications should the parties fail to executive a definitive agreement.

Table of Contents

Changes in Number of Employees

As previously stated, our research, product development, and testing is primarily being conducted by Adaptive. During the reporting period, we retained a senior engineer to assist with the generator development and power production. Subsequent to the reporting period, we retained a consultant to assist us with the upcoming beta testing. We anticipate that we will hire additional full-time employees to assist our operations once the testing and development of our generators and engines is completed and they are ready for manufacture and sale.

Results of Operations for the Three and Six Months Ended December 31, 2005 and December 31, 2004.

We did not earn any revenue during the three or six months ended December 31, 2005 and have not earned any revenue since our inception. We do not anticipate earning any revenue until we have completed testing and development of our engines and generators and commenced the manufacturing of these products.

We incurred operating expenses in the amount of \$1,791,007 for the three months ended December 31, 2005, compared to operating expenses of \$106,849 for the three months ended December 31, 2004. We incurred operating expenses in the amount of \$3,405,064 for the six months ended December 31, 2005, compared to operating expenses of \$1,027,349 for the six months ended December 31, 2004. The increase in our operating expenses for the three and six months ended December 31, 2005 was primarily attributable to research and development expenses and professional and consulting fees. We incurred research and development expenses in the amount of \$1,023,360 for the three months ended December 31, 2005 and \$2,239,211 for the six months ended December 31, 2005, compared to no research and development expenses during the same reporting periods in the prior year. We incurred professional and consulting fees in the amount of \$431,716 for the three months ended December 31, 2005, compared to \$82,000 during the same period in the prior year. We incurred professional and consulting fees in the amount of \$658,879 for the six months ended December 31, 2005, compared to \$174,500 during the same period in the prior year.

We have incurred a net loss of \$1,804,830 for the three months ended December 31, 2005, compared to \$108,700 for the three months ended December 31, 2004. We have incurred a net loss of \$3,434,143 for the six months ended December 31, 2005, compared to net income of \$594,300 for the six months ended December 31, 2004. The recording of net income for the six months ended December 31, 2004 is attributable to the impairment of goodwill and intangibles in three months ended September 30, 2004 resulting the impairment of intellectual property from Transporter, Inc. which we acquired.

Liquidity and Capital Resources

As of December 31, 2005, we had current assets in the amount of \$522,387 and current liabilities in the amount of \$4,301,421. We had a working capital deficit of \$3,779,034 on December 31, 2005. As a result, we have insufficient working capital to implement our business plan. Our operations for the reporting period were primarily funded through equity financings.

We have not attained profitable operations and are dependent upon obtaining financing to continue operations. We can provide no assurance that we will receive adequate financing. For these reasons, our auditors have stated in their report that they have substantial doubt about our ability to continue as a going concern.

Table of Contents

The completion of our business plan over the next twelve months is contingent upon us obtaining \$6,000,000 in additional financing. At the present time, we have entered discussions with potential investors and do not have any agreements finalized at the present time. We can provide no assurance that we will receive the additional financing we are seeking.

Off Balance Sheet Arrangements

As of December 31, 2005, there were no off balance sheet arrangements. Please refer to the Commitment and Contingency footnote to our consolidated financial statements included elsewhere herein.

Going Concern

We are currently in the development stage, and there is no guarantee whether we will be able to generate enough revenue and/or raise capital to support current operations and generate anticipated sales. Our independent auditors indicated that this raises substantial doubt about our ability to continue as a going concern.

Management believes that the capital requirements will depend on many factors including the success of our product development efforts.

The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

Item 3. Controls and Procedures

We carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of December 31, 2005. This evaluation was carried out under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, Dr. Raymond Brouzes. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2005, our disclosure controls and procedures are effective. There have been no significant changes in our internal controls over financial reporting during the quarter ended December 31, 2005 that have materially affected or are reasonably likely to materially affect such controls.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act are recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Table of Contents

Limitations on the Effectiveness of Internal Controls

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

Table of Contents

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

Except as provided below, there have been no material developments in the ongoing legal proceedings previously reported in which we are a party. More discussion of our ongoing legal proceedings is discussed in our annual report on Form 10-KSB for the year ended June 30, 2005 and in our quarterly report for the three months ended September 30, 2005.

Axial Vector Engine Corporation v. Dyna-Cam Engine Corporation, et. al in the U.S. District Court, District of Central California

On October 26, 2005, we filed a request with the United States District Court, Central District of California (the "Court") to temporarily restrain defendants Dyna-Cam Engine Corporation, Patricia Wilks and Dennis Palmer (the "Defendants") from using the "Dyna-Cam" mark, similar names and marks, and other intellectual property, and to set a hearing for a preliminary injunction. The Court granted our request, issued a temporary restraining order ("TRO"), and set a hearing for November 9, 2005 to determine whether the Defendants should be enjoined pending trial of this case from using the "Dyna-Cam" mark, similar names and marks, and other intellectual property. On November 9, 2005, the Court converted our TRO into a preliminary injunction until the matter is resolved. No trial date has been set and discovery is ongoing.

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

The information set forth below relates to our issuances of equity securities without registration under the Securities Act of 1933 during the reporting period.

On April 25, 2005, we completed a Financing Agreement in the amount of \$4,000,000 with Alliance Capital Management. Under the terms of this agreement, we will receive \$400,000 dollars each month for ten months commencing in May of 2005. The monthly payments are convertible in common stock and the amount of shares issued is determined based on 75% of the previous ten day trading average of the company prior to the issuance. Pursuant to the terms of the Financing Agreement described above, we issued the following shares of common stock to Alliance Capital Management during and subsequent to the reporting period: (a) 286,792 shares of common stock on October 20, 2005, (b) 159,363 shares of common stock on November 11, 2005, and 254,777 shares of common stock on December 20, 2005. These issuances are exempt pursuant to Regulation S of the Securities Act. Alliance Capital Management is a non-US person as defined in Regulation S. We did not engage in a distribution of this offering in the United States. The purchaser represented his intention to acquire the securities for investment only and not with a view toward distribution. We requested that our stock transfer agent affix the appropriate restrictive legend to the stock certificate issued in accordance with Regulation S. The investor was given adequate access to sufficient information about us to make an informed investment decision. These securities were not sold through an underwriter and accordingly, there were no underwriting discounts or commissions involved. No registration rights were granted to the purchaser.

Table of Contents

On July 22, 2005, we entered into a Management Consulting Agreement (the "MCA") with Twilight Bay L.L.C. ("Twilight Bay") whereby Twilight Bay agreed to provide administrative and marketing consulting services, including, but not limited to a positioning statement, corporate profile, public relations, and logos and designs in exchange for the issuance of 1,465,000 shares of our common stock. These shares were issued pursuant to Section 4(2) of the Securities Act. We did not engage in any general solicitation or advertising. We issued the stock certificates and affixed the appropriate legends to the restricted stock. On November 1, 2005, the parties agreed to terminate the MCA and the shares issued to Twilight Bay were returned for cancellation.

On October 20, 2005, we entered into a business consulting agreement ("consulting agreement") with a consultant. Pursuant to the terms of the consulting agreement, we agreed to issue 10,000 shares of our common stock each month for twelve (12) months commencing in November 2005. During the reporting period, we issued a total of 20,000 shares of our common stock as required under the consulting agreement. Under the terms of the consulting agreement, we also issued warrants to purchase 105,000 shares of our common stock vesting one-twelfth per month from the date of the consulting agreement until fully vested. All vested warrants are exercisable for a period of two (2) years from the expiration or termination date of the consulting agreement. The exercise price of the warrants is as follows: 35,000 of the warrants are exercisable at the exercise price of \$4.00 per share, 35,000 of the warrants are exercisable at the exercise price of \$4.50 per share, and 35,000 of the warrants are exercisable at the exercise price of \$5.00 per share. All shares and warrants were issued pursuant to Section 4(2) of the Securities Act. We did not engage in any general solicitation or advertising. We issued the stock certificates and affixed the appropriate legends to the restricted stock.

Pursuant to the terms of a consulting agreement entered into on November 9, 2005, we issued 50,000 shares of our common stock to a consultant for services rendered. We also issued 100,000 pursuant to the terms of the consulting agreement and these shares are being held in escrow until certain conditions set forth in the consulting agreement have been satisfied. These shares were issued pursuant to Section 4(2) of the Securities Act. We did not engage in any general solicitation or advertising. We issued the stock certificates and affixed the appropriate legends to the restricted stock.

During the reporting period, we issued 25,000 shares of our common stock to a consultant for services rendered. These shares were issued pursuant to Section 4(2) of the Securities Act. We did not engage in any general solicitation or advertising. We issued the stock certificates and affixed the appropriate legends to the restricted stock.

During the reporting period, we granted an employee options to purchase 15,000 shares of our common stock exercisable for a period of ten years at the exercise price of \$2.15 per share. These shares and options were issued pursuant to Section 4(2) of the Securities Act of 1933, as amended.

Item 3. Defaults upon Senior Securities

None

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

No matters have been submitted to our security holders for a vote, through the solicitation of proxies or otherwise, during the quarterly period ended December 31, 2005.

Item 5. Other Information

None.

Table of Contents**Item 6. Exhibits**

Exhibit Number	Description of Exhibit
10.1	Joint Venture Agreement with Adaptive Propulsion Systems, LLC ¹
10.2	Addendum to Joint Venture Agreement with Adaptive Propulsion Systems, LLC ³
10.3	Contract for Production of Generators with Adaptive Propulsion Systems, LLC ¹
10.4	Exclusive Purchase Agreement ²
10.5	Memorandum of Understanding with Kirloskar Oil Engines Limited ³
31.1	<u>Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2	<u>Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
32.1	<u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>

¹ Previously filed as an exhibit to the quarterly report on Form 10-QSB for the period ended March 31, 2005 and filed with the Securities and Exchange Commission on May 24, 2005

² Previously filed as an exhibit to a current report on Form 8-K filed with the Securities and Exchange Commission on September 2, 2004

³ Previously filed as an exhibit to the annual report on Form 10-KSB for the year ended June 30, 2005 and filed with the Securities and Exchange Commission on October 14, 2005

SIGNATURES

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

AXIAL VECTOR ENGINE CORPORATION

Date: February 21, 2006

By: /s/ Dr. Raymond Brouzes

Dr. Raymond Brouzes

Title: **Chief Executive Officer, Chief Financial Officer,
and Director**

