

AXIAL VECTOR ENGINE CORP  
Form 10KSB  
October 14, 2005

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

**FORM 10-KSB**

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the fiscal year ended June 30, 2005  
TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT

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

Commission file number 000-49698

**Axial Vector Engine Corporation**

(Name of small business issuer in its charter)

**Nevada**

(State or other jurisdiction of incorporation or  
organization)

**20-3362479**

(I.R.S. Employer Identification No.)

**One World Trade Center**

**121 S.W. Salmon Street, Suite 1100**

**Portland, Oregon**

(Address of principal executive offices)

**97204**

(Zip Code)

Issuer's telephone number: 503-471-1348

Securities registered under Section 12(b) of the Exchange Act:

Title of each class

Name of each exchange on which  
registered

None

Not Applicable

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, par value \$0.001

(Title of class)

Check whether the Issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act during the past 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.

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Yes  No

Check if disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

State issuer's revenue for its most recent fiscal year. **\$0**

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the average bid and asked price of such common equity, as of a specified date within the past 60 days.

**\$58,371,069 as of September 29, 2005**

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date. **34,653,780 Common Shares as of September 7, 2005**

Transitional Small Business Disclosure Format (Check One): Yes  No

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**PART I**

**Item 1: Description of Business**

**Overview**

We were incorporated in the state of Nevada on May 10, 2001.

On June 30, 2003, we acquired the operating assets of Dyna-Cam Engine Corp. ("Dyna-Cam"). Dyna-Cam was a development stage company that possessed the intellectual property rights for a unique, axial cam-drive, free piston, internal combustion engine. We acquired the assets of Dyna-Cam with the intention to further develop, produce, and sell this engine primarily for aircraft and marine applications. As a result of insufficient capital, we never were able to commence operations.

On January 6, 2005, prior management resigned and appointed new management. On this date, Dr. Raymond Brouzes became our chief executive officer and was appointed as a member of our board of directors. Samuel J. Higgins became our secretary and treasurer and was appointed as a member of our board of directors. Benjamin Langford was also appointed to serve as members of our board of directors.

Following this change in management, we abandoned our plans to utilize the engine as designed by Dyna-Cam Engine Corp. We identified an engine with technologies that incorporate significantly enhanced performance characteristics and new design features that make pursuing the development, manufacture, and sale of this engine more advantageous. This engine was designed utilizing the concepts of the original Axial Vector engine. Our efforts currently have been devoted to further developing and testing the performance of this engine.

On May 20, 2005, our shareholders approved a change in our name to Axial Vector Engine Corporation in order to more closely reflect the business direction of our company.

**Status of Product Development for Engine with Axial Vector Design**

On August 24, 2004, we entered into a License Agreement ("Agreement") with Adaptive Propulsion Systems, LLC ("Adaptive") to assist us with the testing of our engine that uses the Axial Vector design and in-house trials. Adaptive volunteered to upgrade the engine from a "mechanical" engine to a "digital" engine with a number of significant changes in design and materials. We will own the rights to all new technologies and patentable ideas that result from any upgrades undertaken by Adaptive. Adaptive is currently in the final phase of technological improvements. Adaptive's progress through this testing phase has been swift and field trials are scheduled for the first quarter of 2006. In mid-January we anticipate that we will also commence the MTF dynamometer testing. The planned MTF dynamometer testing will consist of running the engine for 60 days and taking measurements of engine components to estimate the wear at various time intervals. 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 dynamometer testing, further modifications may be required.

We now anticipate that all testing and modifications will be completed prior to the end of the next fiscal year on June 30, 2006 and manufacturing will have commenced by this time.

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**Status of Product Development for Generators that Utilize our Axial Vector Engine**

On January 13, 2005, we entered into a Contract for the Production of Generator Systems 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 secured financing and satisfied the contingency in this agreement. We intend to build several models of generators that utilize our Axial Vector engine. We are seeking to build 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.

The development process for these power generators commenced in the last quarter of the fiscal year ended June 30, 2005. We anticipate that Adaptive will be able to comply with the terms of this agreement and complete the development of our initial power generator product line within the next 300 days. We anticipate that Adaptive will be able to fulfill its obligations under the agreement within the contemplated time frame. Based upon design changes made to our family of generators at our request, our management anticipates that we may grant Adaptive an extension to fulfill its obligations under the agreement in light of these changes.

**Employees**

We have 2 full-time employees in addition to our officers, Dr. Raymond Brouzes and Samuel J. Higgins.

**Patents, Licenses, Trademarks, Franchises, Concessions, Royalty Agreements, or Labor Contracts**

Trademarks

We currently have trademark applications pending with the United States Patent and Trademark Office and the Canadian Intellectual Property Office for protection of the mark "AV" and "AVE."

Patents

The company has holds two issued patents and has various patent applications pending which cover one or more aspects of the current version of the axial vector engine or predecessor models.

Licenses

In a Joint Venture Agreement entered into with Adaptive on August 24, 2004, we granted Adaptive the exclusive right to sell the Axial Vector engine to the United States military and all militaries of NATO countries. This Agreement was later amended to include the military

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of the United Arab Emirates.

In a Contract for the Production of Generator Systems entered into with Adaptive on January 13, 2005, we granted Adaptive the exclusive right to sell the family of generators that utilize our Axial Vector engine to the United States military and all militaries of NATO countries.

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 is anticipated to be occur in January 2006. 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.

## **Research and Development**

We incurred research and development expenditures in the amount of approximately \$1,600,000 for the fiscal year ended June 30, 2005. These expenditures were paid to Adaptive to conduct research and development for a family of generators that utilize our Axial Vector engine. We did not incur any research and development expenditures for the fiscal year ended June 30, 2004.

## **Existing and Probable Governmental Regulation**

We are not subject to any significant or material federal or state government regulation in connection with the research, development, and licensing of engines that use the Axial Vector design.

## **Compliance with Environmental Laws**

We did not incur any costs in connection with the compliance with any federal, state, or local environmental laws.

## **Competition**

There is significant competition in the engine and generator manufacturing industry. Our management in unaware of any current engine and generator manufactures that incorporates the axial vector design into its engines or generators.

## **Item 2: Description of Property**

Currently, we do not own any real estate. We are leasing our executive offices at One World Trade Center, 121 S.W. Salmon Street, Suite 1100, Portland, Oregon, 97204.

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**Item 3: Legal Proceedings**

In October 2004, we filed a complaint against Patricia Wilks and Dennis Palmer in the United States District Court, Central District of California. We later amended our complaint to include Dyna-Cam Engine Corporation as a defendant. Our original complaint stated five causes of action for declaratory judgment regarding intellectual property rights, common law misrepresentation, intentional interference with contractual relations and unfair competition, seeking relief declaratory and injunctive relief, damages, costs and attorneys' fees. We amended our complaint to include a total of seventeen causes of action. Additional causes of action included violations of the trade secrets act, negligent interference with contractual and prospective business relationships, breach of covenant of good faith and fair dealing, and unjust enrichment. The defendants answered by generally denied our substantive allegations and have counterclaimed for fraud and breach of contract, seeking compensatory, special and punitive damages. We have generally denied these allegations. The issues in dispute include the enforceability of, and the rights and obligations of the parties pursuant to, written agreements that resulted in the transfer of certain assets and intellectual property to us, including the Dyna-Cam engine. Defendants have sought to avoid the operation of those agreements by alleging both that they were fraudulently induced into executing the agreements and that we have breached the terms thereof. The case is in discovery. We intend to aggressively pursue our claims and defend the Defendants' counterclaims. The defendant's responsive pleading to our amended complaint is currently due.

On April 29, 2005, three (3) former employees filed a lawsuit against us in New York Supreme Court, County of Suffolk, Riverhead. The former employees collectively are seeking compensation and liquidated damages in the amount of approximately \$22,907,500 based upon a cause of action for breach of employment agreements. The plaintiffs are alleging that they were fired without cause in order to avoid the payment of stock options set forth in their employment agreements. No trial date has been set. We believe the lawsuit is without merit and we are aggressively defending this case.

In May 2005, we filed suit against Transporter, Inc. and its principals, Daniel Werner and Craig Della Penna. The suit seeks to rescind an August 2004 agreement under which we acquired the exclusive rights to certain video conference technology owned by Transporter, Inc. We contend that Mr. Della Penna and Mr. Werner intentionally misrepresented the status and capabilities of the technology being acquired under the agreement. Shortly after the suit was filed, Mr. Della Penna and Mr. Werner placed Transporter into chapter 7 bankruptcy proceedings in the U.S. Bankruptcy Court for the District of Oregon, Case No. 05-36661-elp7. We are currently seeking relief from stay in the Transporter bankruptcy case and are also exploring settlement options with the trustee appointed to oversee Transporter's liquidation under bankruptcy code. Our action against Transporter, Inc., Della Penna, and Werner was originally filed in the United States District Court for the District of Nevada. Venue has been transferred to the United States District Court for the District of Oregon and the action is currently pending there as Case No. 05-CV01469-AS. Answers to our complaint are currently due from Mr. Della Penna and Mr. Werner.

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On May 26, 2005, Focus Partners filed suit against us in the Supreme Court of the State of New York, New York County, alleging that it was due additional monies pursuant to a penalty provisions that existed in an agreement between the parties. We paid Focus Partners the appropriate consideration due under the agreement in question. Our position is that the penalty provision in the agreement was waived by Focus Partners.

**Item 4: Submission of Matters to a Vote of Security Holders**

During the fourth quarter of the reporting period, we held our annual meeting of shareholders. The matters voted upon at the meeting were as follows:

- To consider and act upon a proposal to amend the our Articles of Incorporation to change the name of the corporate entity to Axial Vector Engine Corporation;
  - To confirm the appointment of Bagell, Josephs & Company, L.L.C. as our auditors;
    - To ratify our 2005 stock option plan; and
- To elect three directors for a term expiring at the next annual meeting of shareholders, or until their successors are duly elected or qualified

The total number of shares of common stock outstanding at the record date, March 31, 2005, was 28,862,942 shares. The number of votes represented at this meeting was 23,802,388 shares, or approximately 82% of shares eligible to vote.

The amendment to the Articles of Incorporation to change the name of the corporate entity to Axial Vector Engine Corporation was approved and the results were as follows:

Votes for	Votes Against	Abstentions
23,800,388	0	2,000

The shareholders confirmed the appointment of Bagell, Josephs & Company, L.L.C. as our auditors and the results were as follows:

Votes for	Votes Against	Abstentions
23,802,388	0	0

The shareholders ratified our 2005 stock option plan and the results were as follows:

Votes for	Votes Against	Abstentions
23,800,363	0	2,025



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All of the nominees for director recommended by the board of directors were elected and the results of the voting were as follows:

Name	Votes for	Votes Against	Abstentions
Dr. Raymond Brouzes	23,800,378	0	2,010
Samuel J. Higgins	23,800,378	0	2,010
Benjamin Langford	23,800,378	0	2,010

**PART II****Item 5: Market for Common Equity and Related Stockholder Matters****Market Information**

Our common stock is currently quoted on the OTC Bulletin Board (“OTCBB”), which is sponsored by the NASD. The OTCBB is a network of security dealers who buy and sell stock. The dealers are connected by a computer network that provides information on current "bids" and "asks", as well as volume information. Our shares are quoted on the OTCBB under the symbol “AXVC.”

The following table sets forth the range of high and low bid quotations for our common stock for each of the periods indicated as reported by the OTCBB. These quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

Fiscal Year Ending June 30, 2005		
Quarter Ended	High \$	Low \$
June 30, 2005	6.62	1.80
March 31, 2005	2.35	0.65
December 31, 2004	5.00	0.60
September 30, 2004	6.25	0.11
Fiscal Year Ended June 30, 2004		
Quarter Ended	High \$	Low \$
June 30, 2004	0.28	0.13
March 31, 2004	0.85	0.17

December 31, 2003	1.25	0.365
September 30, 2003	2.53	0.25

On September 29, 2005, the last sales price of our common stock was \$3.88.

### **Penny Stock**

The SEC has adopted rules that regulate broker-dealer practices in connection with transactions in penny stocks. Penny stocks are generally equity securities with a market price of less than \$5.00, other than securities registered on certain national securities exchanges or quoted on the NASDAQ system, provided that current price and volume information with respect to transactions in such securities is provided by the exchange or system. The penny stock rules

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require a broker-dealer, prior to a transaction in a penny stock, to deliver a standardized risk disclosure document prepared by the SEC, that: (a) contains a description of the nature and level of risk in the market for penny stocks in both public offerings and secondary trading; (b) contains a description of the broker's or dealer's duties to the customer and of the rights and remedies available to the customer with respect to a violation of such duties or other requirements of the securities laws; (c) contains a brief, clear, narrative description of a dealer market, including bid and ask prices for penny stocks and the significance of the spread between the bid and ask price; (d) contains a toll-free telephone number for inquiries on disciplinary actions; (e) defines significant terms in the disclosure document or in the conduct of trading in penny stocks; and (f) contains such other information and is in such form, including language, type, size and format, as the SEC shall require by rule or regulation.

The broker-dealer also must provide, prior to effecting any transaction in a penny stock, the customer with (a) bid and offer quotations for the penny stock; (b) the compensation of the broker-dealer and its salesperson in the transaction; (c) the number of shares to which such bid and ask prices apply, or other comparable information relating to the depth and liquidity of the market for such stock; and (d) a monthly account statement showing the market value of each penny stock held in the customer's account.

In addition, the penny stock rules require that prior to a transaction in a penny stock not otherwise exempt from those rules; the broker-dealer must make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written acknowledgment of the receipt of a risk disclosure statement, a written agreement as to transactions involving penny stocks, and a signed and dated copy of a written suitability statement.

These disclosure requirements may have the effect of reducing the trading activity for our common stock. Therefore, stockholders may have difficulty selling our securities.

## **Holders of Our Common Stock**

As of September 7, 2005, we had approximately one hundred seventy five (175) holders of record of our common stock and several other stockholders hold shares in street name.

## **Dividends**

There are no restrictions in our articles of incorporation or bylaws that restrict us from declaring dividends. The Nevada Revised Statutes, however, do prohibit us from declaring dividends where, after giving effect to the distribution of the dividend:

1. We would not be able to pay our debts as they become due in the usual course of business; or
2. Our total assets would be less than the sum of our total liabilities, plus the amount that would be needed to satisfy the rights of shareholders who have preferential rights superior to those receiving the distribution.

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We have not declared any dividends, and we do not plan to declare any dividends in the foreseeable future.

**Recent Sales of Unregistered Securities**

The information set forth below relates to our issuances of equity securities without registration under the Securities Act of 1933 during the fiscal year ended June 30, 2005.

On August 24, 2004, we issued 25,000,000 shares of our common stock to International Equity Partners, SA as part of the consideration paid for the assignment of all rights, title, and interest in an Exclusive Purchase Agreement between International Equity Partners, SA and Transporter Inc. These shares were issued pursuant to Section 4(2) of the Securities Act of 1933, as amended. We did not engage in any general solicitation or advertising. International Equity Partners, SA was given adequate information about us to make an informed investment decision. We issued the stock certificates and affixed the appropriate legends to the restricted stock.

On September 17, 2004, we issued a total of 1,000,000 shares of our common stock to Craig Della Penna and Daniel H. Werner as part of the consideration paid for the acquisition of all of the issued and outstanding shares of Transporter, Inc. pursuant to the terms of an Exclusive Purchase Agreement entered into on August 24, 2004. These shares were issued pursuant to Section 4(2) of the Securities Act. Each purchaser represented his or her intention to acquire the securities for investment only and not with a view toward distribution. Each investor was given adequate information about us to make an informed investment decision. 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 8, 2004, we issued 157,788 shares of our common stock to one (1) investor at the price of \$0.50 per share. We received proceeds of \$78,894 and no commissions were paid on the issuance of these shares. These shares were issued pursuant to Section 4(2) of the Securities Act. The purchaser represented his intention to acquire the securities for investment only and not with a view toward distribution. The investor was given adequate information about us to make an informed investment decision. 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 February 28, 2005, we issued 100,000 shares of common stock at the price of \$0.001 per share to one (1) investor. We received proceeds of \$100 and no commissions were paid on the issuance of these shares. These shares were issued pursuant to Section 4(2) of the Securities Act. The purchaser represented his intention to acquire the securities for investment only and not with a view toward distribution. The investor was given adequate information about us to make an informed investment decision. 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 April 6, 2005, we issued a total of 1,125,811 shares of our common stock to eight (8) investors at the price of \$0.50 per share. We received proceeds of \$562,901 and no commissions were paid on the issuance of these shares. These shares were issued pursuant to Section 4(2) of the Securities Act. Each purchaser represented his or her intention to acquire the securities for

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investment only and not with a view toward distribution. Each investor was given adequate information about us to make an informed investment decision. We did not engage in any general solicitation or advertising. We issued the stock certificates and affixed the appropriate legends to the restricted stock.

In April 2005, we issued 50,000 shares of our common stock to a consultant for services rendered to the company. 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 April 15, 2005, we issued 600,000 shares of our common stock to our Chief Executive Officer, Chief Financial Officer, and member of our board of directors, Dr. Raymond Brouzes, as compensation for services rendered to the company. 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 April 15, 2005, we issued 20,000 shares of restricted common stock to Focus Partners, LLC pursuant to a settlement agreement resolving claims made by Focus Partners, LLC. 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 April 17, 2005, we issued 1,465,000 shares of common stock to Arube Holdings Inc. upon the execution of a management consulting contract. These shares were issued pursuant to Section 4(2) of the Securities Act of 1933, as amended. We did not engage in any general solicitation or advertising. The Arube Holdings Inc. was given adequate access to sufficient information about us.

On April 20, 2005, we completed an offering of 1,800,000 Units at the price of \$0.50 per Unit to one investor. Each Unit consists of one (1) share of common stock, par value \$0.001, and one (1) Warrant (the "Warrant") to purchase one (1) share of common stock, exercisable for two (2) years from the closing of the offering. The exercise price for the Warrant is priced at \$3.00 per share. The total amount we received from this offering was \$900,000. Assuming that all of the warrants are exercised by the investor, the gross proceeds received from the warrants will equal \$5,400,000. This issuance was exempt pursuant to Regulation S of the Securities Act. The purchaser represented to us that he was 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 our stock transfer agent to affix appropriate restrictive legend to the stock certificate issued to each purchaser 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.

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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: (a) 200,000 shares on April 25, 2005; (b) 173,724 shares on June 8, 2005; (c) 149,254 shares on July 28, 2005; (d) 201,005 shares on August 9, 2005; and (e) 189,983 shares in September 2005. These issuances are exempt pursuant to Regulation S of the Securities Act. The purchaser represented to us that he was 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.

In June 2005, we issued 90,000 shares of our common stock to a consultant for services rendered to the company. 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.

**Equity Compensation Plans as of June 30, 2005**

	A	B	C
<b>Plan Category</b>	<b>Number of securities to be issued upon exercise of outstanding options, warrants and rights</b>	<b>Weighted-average exercise price of outstanding options, warrants and right</b>	<b>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (A))</b>
Equity compensation plans approved by security holders	4,244,874	\$1.53	4,044,874
Equity compensation plans not approved by security	2,000,000	\$1.52	2,000,000

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holders			
Total	6,244,874	\$1.53	6,044,874

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The table set forth above provides information about our equity compensation plans under which shares of common stock may be issued upon the exercise of options as of June 30, 2005. Our shareholders ratified our 2005 stock option plan at our annual shareholder meeting on May 20, 2005. The material portions of the 2005 stock option plan were disclosed in the definitive proxy statement mailing to our shareholders on May 9, 2005.

Our April 14, 2005, our board of directors authorized the issuance of options to purchase 1,000,000 shares of our common stock at the price of \$1.52 per share with an expiration date of April 14, 2010 to Dr. Raymond Brouzes, our CEO, CFO, and member of our board of directors.

Our April 14, 2005, our board of directors authorized the issuance of options to purchase 1,000,000 shares of our common stock at the price of \$1.52 per share with an expiration date of April 14, 2010 to Mr. Samuel Higgins, a member of our board of directors.

Our shareholders did not approve these individual compensation arrangements for Dr. Brouzes or Mr. Higgins.

## **Item 6: 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 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, significant restructuring activities in calendar 2004 and thereafter, 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.



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**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 License 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.

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.

During the last quarter of the fiscal year, Adaptive conducted an engine endurance evaluation using digital simulation with the assistance of a software product. This particular testing is useful in estimating the Mean Time to Failure (“MTF”) of our engine utilizing the axial vector design. Further testing on our Axial Vector design still remains. We anticipate that by mid-January all of our engine components will be fully operational and the engine will be operating consistently at the targeted performance level. In mid-January we anticipate that we will commence the MTF dynamometer testing. The planned MTF dynamometer testing will consist of running the engine for 60 days and taking measurements of engine components to estimate the wear at various time intervals. 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 dynamometer testing, further modifications may be required.

We now anticipate that all testing and modifications will be completed prior to the end of the next fiscal year on June 30, 2006 and manufacturing will have commenced by this time.

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,

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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 are seeking to build 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 will pay Adaptive \$3,171,000 to complete the development of our 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 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 5 years unless revised by joint agreement of the parties.

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. We anticipate that Adaptive will be able to comply with the terms of this agreement and complete the development of our initial power generator product line within the next 300 days. We anticipate that Adaptive will be able to fulfill its obligations under the agreement within the contemplated time frame.

**Purchase and Sale of Plant or Significant Equipment**

Within the next twelve months, we anticipate that we will acquire a facility and equipment to be utilized primarily for our research and development needs. We are seeking to establish this facility in Long Island, New York and we propose to refer to this facility as the "Axial Vector Center of Excellence for Propulsion and Power Generation."

**Changes in Number of Employees**

We anticipate that we will hire additional full-time employees as needed to assist our operations once the testing and development of our generators and engines is completed and

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they are ready for manufacture and sale.

**Results of Operations for the Years Ended June 30, 2005 and June 30, 2004.**

We did not earn any revenue during the year ended June 30, 2005 and have not earned any revenue since our inception. We do not anticipate earning any revenue until such time that we have complete the testing and development of our engines and generators and commence the manufacturing of these products.

We incurred operating expenses in the amount of \$11,463,294 for the year ended June 30, 2005, compared to operating expenses of \$5,277,500 for the year ended June 30, 2004. The increase in our operating expenses for the year ended June 30, 2005 was primarily attributable to significant increases in expenditures for professional and consulting fees, compensation expense, and the impairment of goodwill and intangibles. We incurred compensation expense in the amount of \$1,113,495 for the year ended June 30, 2005, compared to \$432,969 in the prior year. We incurred professional and consulting fees in the amount of \$4,863,366 for the year ended June 30, 2005, compared to \$1,954,914 in the prior year. We recorded the impairment of goodwill and intangibles in the amount of \$3,862,500 for the year ended June 30, 2005, compared to \$701,347 in the prior year. The recorded impairment of goodwill and intangibles for the year ended June 30, 2005 was entirely attributable to the impairment of intellectual property from Transporter, Inc. which we acquired.

We have incurred a net loss of \$11,455,616 for the year ended June 30, 2005, compared to \$5,294,630 for the year ended June 30, 2004. Our losses for the year ended June 30, 2005 and 2004 are entirely attributable to operating expenses and the impairment of goodwill.

**Liquidity and Capital Resources**

As of June 30, 2005, we had current assets in the amount of \$52,360 and current liabilities in the amount of \$3,939,492. We had a working capital deficit of \$3,887,132 on June 30, 2005. As a result, we have insufficient capital to implement our business plan.

Our operations for the fiscal year ended June 30, 2005 were primarily funded through debt and equity financings. On May 18, 2005, we received \$600,000 from Samuel J. Higgins, a member of our board of directors, on demand together with interest of 5% per annum. The total amount of this loan was later increased to \$1,246,000. In addition to this loan, we have secured financing through private equity offerings during the reporting period.

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.

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

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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 June 30, 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 have stated in their Auditor's Report 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.

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**Item 7: Financial Statements**

Index to Consolidated Financial Statements:

**Audited Financial Statements:**

F-1	Report of Independent Registered Public Accounting Firm;
F-2	Balance Sheets as of June 30, 2005 and 2004;
F-3	Statements of Operations for the Years Ended June 30, 2005 and 2004 and for the period December 30, 2002 (Inception) through June 30, 2005 with Cumulative Total Since Inception;
F-4	Statement of Stockholders' Equity (Deficit) for the Years Ended June 30, 2005 and 2004 and for the period December 30, 2002 (Inception) through June 30, 2005;
F-5	Statements of Cash Flows for the Years Ended June 30, 2005 and 2004 and for the period December 30, 2002 (Inception) through June 30, 2005 with Cumulative Total Since Inception; and
F-6	Notes to Financial Statements

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders  
Axial Vector Engine Corporation  
Portland, OR

We have audited the accompanying consolidated balance sheets of Axial Vector Engine Corporation and Subsidiary as of June 30, 2005 and June 30, 2004 and the related consolidated statements of operations, stockholders' deficit, and cash flow for the years then ended and the period December 30, 2002 (Inception) through June 30, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 10 to the consolidated financial statements, the Company has sustained operating losses and capital deficits that raise substantial doubt about its ability to continue as a going concern. Management's operating and financing plans in regards to these matters are also discussed in Note 10. The consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Axial Vector Engine Corporation and Subsidiary as of June 30, 2005 and 2004, and the results of its operations, and cash flows for the years then ended, and the period December 20, 2002 (Inception) through June 30, 2005, in conformity with accounting principles generally accepted in the United States of America.

Bagell, Josephs, Levine & Company, L.L.C.

Bagell, Josephs, Levine & Company, L.L.C.  
Gibbsboro, New Jersey

October 9, 2005

**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY**  
**(FORMERLY AERO MARINE ENGINE, INC.)**  
**(A DEVELOPMENT STAGE COMPANY)**  
**CONSOLIDATED BALANCE SHEETS**  
**JUNE 30, 2005 AND 2004**

**ASSETS**

	2005	2004
Current Assets:		
Cash and cash equivalents	\$ 7,360	\$ -
Inventory	-	-
Deposit	22,670	22,670
Prepaid expenses	22,330	-
<b>Total Current assets</b>	<b>52,360</b>	<b>22,670</b>
Property and equipment, net	21,142	-
Intangible assets, net	63,750	-
<b>TOTAL ASSETS</b>	<b>\$ 137,252</b>	<b>\$ 22,670</b>

**LIABILITIES AND STOCKHOLDERS' DEFICIT**

**LIABILITIES**

Current Liabilities:		
Accounts payable and accrued expenses	\$ 131,417	\$ 56,960
Current portion of note payable	1,500,000	-
Liability for stock to be issued	749,949	-
Due to shareholders	1,246,787	499,776
Due to related company	311,339	314,339
<b>Total Current liabilities</b>	<b>3,939,492</b>	<b>871,075</b>
Note payable - net of current portion	1,495,000	-
<b>Total Liabilities</b>	<b>5,434,492</b>	<b>871,075</b>

**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	-	-

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32,162,762 and 541,349 shares issued and outstanding	32,162	541
Additional paid-in capital	11,558,126	4,582,966
Deficit accumulated during the development stage	(16,887,528)	(5,431,912)
<b>Total Stockholders' Deficit</b>	<b>(5,297,240)</b>	<b>(848,405)</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT \$</b>	<b>137,252 \$</b>	<b>22,670</b>

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

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**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY**  
**(FORMERLY AERO MARINE ENGINE, INC.)**  
**(A DEVELOPMENT STAGE COMPANY)**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE YEARS ENDED JUNE 30, 2005 AND 2004**  
**(WITH CUMULATIVE TOTALS SINCE INCEPTION)**

	2005	2004	Cumulative Totals December 30, 2002 through June 30, 2005
<b>OPERATING REVENUES</b>			
Sales	\$ -	\$ -	\$ -
<b>COST OF SALES</b>			
	-	-	-
<b>GROSS PROFIT</b>			
	-	-	-
<b>OPERATING EXPENSES</b>			
Compensation expense	1,113,495	432,969	1,546,464
Professional and consulting fees	4,863,366	1,954,914	6,955,562
Advertising and promotions	164,185	44,891	209,076
Rent	1,393	42,783	44,176
Impairment of goodwill and intangibles	3,862,500	701,347	4,563,847
Impairment of property and equipment	-	107,964	107,964
Write-off of inventory	-	266,519	266,519
Research and development	759,330	1,571,830	2,331,160
General and administrative expenses	697,171	115,443	812,614
Depreciation and amortization	1,854	38,840	40,694
<b>Total Operating Expenses</b>	<b>11,463,294</b>	<b>5,277,500</b>	<b>16,878,076</b>
<b>NET LOSS BEFORE OTHER INCOME (EXPENSE)</b>			
	(11,463,294)	(5,277,500)	(16,878,076)
<b>OTHER INCOME (EXPENSE)</b>			
Interest income	7,678	-	7,678
Interest expense	-	(17,130)	(17,130)
<b>Total Other Income (Expenses)</b>	<b>7,678</b>	<b>(17,130)</b>	<b>(9,452)</b>
<b>NET LOSS BEFORE PROVISION FOR INCOME TAXES</b>			
	(11,455,616)	(5,294,630)	(16,887,528)

Provision for income taxes	-	-	-
<b>NET LOSS APPLICABLE TO COMMON SHARES</b>	\$ (11,455,616)	\$ (5,294,630)	\$ (16,887,528)
<b>WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING</b>	17,293,298	398,990	
<b>NET LOSS PER BASIC AND DILUTED SHARES</b>	\$ (0.66)	\$ (13.27)	

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

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**AXIAL VECTOR ENGINE CORPORATION AND SUBSIDIARY**  
**(FORMERLY AERO MARINE ENGINE, INC.)**  
**(A DEVELOPMENT STAGE COMPANY)**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
**FOR THE YEARS ENDED JUNE 30, 2005 AND 2004**

Description	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Deficit Accumulated During the Development Stage	Total
Balance, December 30, 2002	37,994,923	\$ 37,995	\$ 1,046,848	\$ -	\$ 1,084,843
Recapitalization for reverse merger	11,000,000	11,000	(61,184)	-	(50,184)
Issuance of shares for services	1,000,000	1,000	27,563	-	28,563
Cancellation of Founder shares	(860,000)	(860)	860	-	-
Net loss for the period December 30, 2002 through June 30, 2003	-	-	-	(137,282)	(137,282)
Balance, June 30, 2003	49,134,923	49,135	1,014,087	(137,282)	925,940
Issuance of shares for services	5,000,000	5,000	3,345,000	-	3,350,000
Conversion of payables to equity	-	-	170,285	-	170,285
Net loss for the year ended June 30, 2004	-	-	-	(5,294,630)	(5,294,630)
Effect of recapitalization 1:100 stock split	(53,593,574)	(53,594)	53,594	-	-
Balance, June 30, 2004	541,349	541	4,582,966	(5,431,912)	(848,405)
Issuance of shares for services	4,039,588	4,040	2,035,931	-	