FLIGHT SAFETY TECHNOLOGIES INC
Form 10QSB
April 13, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**
**FORM 10-QSB**

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

For The Quarterly Period Ended February 28, 2007

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 000-33305

FLIGHT SAFETY TECHNOLOGIES, INC.

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

| | |
|---|---|
| Nevada | 95-4863690 |
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |

28 Cottrell Street, Mystic, Connecticut 06355

(Address of principal executive offices)

(860) 245-0191

(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 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.

Yes x No o

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

Yes o No x

The number of shares of common stock outstanding as of April 13, 2007 was 8,215,210 shares.
Transitional Small Business Disclosure Format: Yes o No x

FLIGHT SAFETY TECHNOLOGIES, INC.
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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

FLIGHT SAFETY TECHNOLOGIES, INC.

**Balance Sheets**
**as of**
**February 28, 2007 and May 31, 2006**
**Unaudited**

| | February 28, 2007 | May 31, 2006 |
|---|---|---|
| Assets | | |
| Current assets: | | |

| | | | | |
|---|---|---|---|---|
| Cash and cash equivalents | $ | 2,799,224 | $ | 145,572 |
| Contract receivables | | 213,964 | | 130,001 |
| Investments available for sale | | 1,250,000 | | 1,661,919 |
| Investments held to maturity | | -- | | 4,337,907 |
| Inventory | | 108,044 | | 108,044 |
| Other current assets | | 177,767 | | 264,750 |
| Total current assets | | 4,548,999 | | 6,648,193 |
| Property and equipment, net of accumulated depreciation of $484,284 and $418,656 | | 129,289 | | 181,606 |
| Other Assets: | | | | |
| Intangible assets, net of accumulated amortization of $80,771 and $ 65,330 | | 260,372 | | 230,750 |
| Other receivables | | 30,884 | | 96,673 |
| Total other assets | | 291,256 | | 327,423 |
| Total Assets | $ | 4,969,544 | $ | 7,157,222 |
| Liabilities and Stockholders' Equity | | | | |
| Current liabilities: | | | | |
| Accounts payable | $ | 354,195 | $ | 603,538 |
| Accrued expenses | | 232,252 | | 228,427 |
| Total current liabilities | | 586,447 | | 831,965 |
| Stockholders' equity: | | | | |
| Preferred Stock, $0.001 par value, 5,000,000 shares authorized, none issued | | --- | | --- |

and outstanding

| | | |
|---|---|---|
| Common stock, $0.001 par value, 50,000,000 shares authorized, 8,331,510 shares issued and 8,215,210 shares outstanding | 8,332 | 8,332 |
| Additional paid-in-capital | 13,070,192 | 13,070,192 |
| Treasury Stock, 116,300 shares at cost | (199,827) | (199,827) |
| Accumulated other comprehensive income | -- | -- |
| Accumulated deficit | (8,495,600) | (6,553,440) |
| Total stockholders' equity | 4,383,097 | 6,325,257 |
| | $ 4,969,544 | $ 7,157,222 |

**Total Liabilities and Stockholders' Equity**

The accompanying notes are an integral part of these financial statements



FLIGHT SAFETY TECHNOLOGIES, INC.

Statements of Operations and Other Comprehensive Income (Loss)
For the Three and Nine Months Ended February 28, 2007 and February 28, 2006
Unaudited

| | Three Months 2007 | Three Months 2006 | Nine Months 2007 | Nine Months 2006 |
|---|---|---|---|---|
| Contract Revenues | $ 182,712 | $ 914,268 | $1,442,739 | $3,652,238 |

| | | | | |
|---|---|---|---|---|
| Cost of Revenues | 334,193 | 469,332 | 1,182,293 | 2,171,700 |
| Gross Profit | (151,481) | 444,936 | 260,446 | 1,480,538 |
| Operating Expenses: | | | | |
| Research and development | 22,535 | 175,018 | 49,463 | 853,198 |
| Selling, general and administrative | 596,942 | 686,816 | 2,283,362 | 1,812,297 |
| Depreciation and amortization | 27,023 | 24,015 | 81,069 | 86,825 |
| Total operating expenses | 646,500 | 885,849 | 2,413,894 | 2,752,320 |
| Loss from Operations | (797,981) | (440,913) | (2,153,448) | (1,271,782) |
| Other Income (Expense) | | | | |
| Interest income | 59,093 | 83,051 | 192,308 | 213,095 |
| Gain (Loss) on investments available for sale | -- | -- | 12,025 | (170,875) |
| Loss before provision for income taxes | (738,888) | (357,862) | (1,949,115) | (1,229,562) |
| Provision for income taxes | (17,925) | 6,200 | (6,955) | 18,600 |
| Net Loss | (720,963) | (364,062) | (1,942,160) | (1,248,162) |
| Other Comprehensive Income (Loss) | | | | |
| Unrealized gains (loss) on investments | -- | (1,348) | 12,025 | (64,191) |
| Less reclassified adjustments | -- | -- | (12,025) | 170,875 |
| Comprehensive Loss | $(720,963)) | $(365,410) | $(1,942,160) | $(1,141,478) |
| Net Loss Per Share | | | | |
| Basic and diluted | $ (.09) | $ (.04) | $ (.24) | $ (.15) |

Weighted Average Number of Shares Outstanding

| | | | | |
|---|---|---|---|---|
| Basic and diluted | 8,215,210 | 8,215,210 | 8,215,210 | 8,215,143 |

The accompanying notes are an integral part of these financial statements



FLIGHT SAFETY TECHNOLOGIES, INC.

Statements of Changes in Stockholders' Equity
For the Nine Months Ended February 28, 2007 and February 28, 2006
Unaudited

| | Common Stock | | Additional Paid - In Capital | Treasury Stock | Accumulated Other Comprehensive Income | Unearned Stock Compensation | Accumulate Deficit |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | | | | | |
| Balance at May 31, 2005 | 8,331,410 | $ 8,331 | 13,069,863 | $ (199,827) | $ (164,023) | $ (4,769) | $ (4,295,881 |
| Amortization of unearned stock comp. | -- | -- | -- | -- | -- | 4,769 | - |
| Warrants Exercised | 100 | 1 | 329 | -- | -- | -- | - |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Other comprehensive income (loss) | -- | | -- | | -- | -- | | 106,684 | | -- | | - |
| Net Loss | -- | | -- | | -- | -- | | -- | | -- | | (1,248,162 |
| Balance at February 28, 2006 | 8,331,510 | $ | 8,332 | $ | 13,070,192 | (199,827) | $ | (57,339) | $ | -- | $ | (5,544,043 |
| Balance at May 31, 2006 | 8,331,510 | $ | 8,332 | $ | 13,070,192 | (199,827) | $ | -- | $ | -- | $ | (6,553,440 |
| Other comprehensive income (loss) | -- | | -- | | -- | -- | | -- | | -- | | - |
| Net loss | -- | | -- | | -- | -- | | -- | | -- | | (1,942,160 |
| Balance at February 28, 2007 | 8,331,510 | $ | 8,332 | $ | 13,070,192 | (199,827) | $ | -- | $ | - - | $ | (8,495,600 |

The accompanying notes are an integral part of these financial statements

FLIGHT SAFETY TECHNOLOGIES, INC.

Statements of Cash Flow
For the Nine Months Ended February 28, 2007 and February 28, 2006
Unaudited

| | For the Nine Months Ended February 28, | |
|---|---|---|
| | 2007 | 2006 |
| Cash flows from operating activities: | | |
| Net loss | $(1,942,160) | $(1,248,162) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 81,068 | 86,825 |
| Non-cash compensation - common stock | -- | 4,769 |
| Gain (Loss) on investment available for sale | (12,025) | 170,875 |
| Accretion of investment discounts | (39,482) | (83,587) |

| | | |
|---|---|---|
| Changes in operating assets and liabilities: | | |
| (Increase) decrease in contract receivables | (83,963) | 128,918 |
| (Increase) decrease in other receivables | 65,789 | 112,036 |
| (Increase) decrease in other current assets and other assets | 86,983 | (205,248) |
| Increase (decrease) in accounts payable and accrued expense | (245,518) | 146,654 |
| Net cash used in operating activities | (2,089,308) | (886,920) |
| Cash flows from investing activities: | | |
| Purchase of held to maturity securities | (3,667,613) | (12,621,944) |
| Proceeds from maturity of held to maturity securities | 8,045,002 | 12,940,000 |
| Proceeds from available for sale securities | 1,123,944 | 500,000 |
| Purchase of available for sale securities | (700,000) | -- |
| Purchases of property and equipment | (13,311) | (61,336) |
| Payments for patents | (45,062) | (55,644) |
| Net cash provided by investing activities | 4,742,960 | 701,076 |
| Net cash provided by (used in) financing activities | -- | -- |
| Cash flows from financing activities: | | |
| Purchase of treasury stock | -- | -- |
| Proceeds from warrants exercised | -- | 30 |
| Net cash provided by (used in) financing activities | -- | 330 |
| Net Increase (decrease) in cash and cash equivalents | 2,653,652 | (185,514) |
| Cash and cash equivalents at beginning of period | 145,572 | 494,837 |
| Cash and cash equivalents at end of period | $2,799,224 | $ 309,323 |

The accompanying notes are an integral part of these financial statements

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FLIGHT SAFETY TECHNOLOGIES, INC.

Notes To The Financial Statements
(Unaudited)
For The Three and Nine Months Ended February 28, 2007 and February 28, 2006

Note 1. Summary of Significant Accounting Policies

**:**

Basis of Presentation

These interim financial statements for the three and nine months ended February 28, 2007 and February 28, 2006, included herein, have been prepared, without audit, pursuant to the rules and regulations of the SEC. Results for the three and nine months ended February 28, 2007 and February 28, 2006 are not necessarily indicative of results for the entire year. In the opinion of management, all adjustments, consisting of normal recurring adjustments, which are necessary for a fair statement of operating results for the interim period have been made. These financial statements do not include all disclosures associated with annual financial statements and, accordingly, should be read in conjunction with our financial statements and related footnotes for the years ended May 31, 2006 and May 31, 2005 which are included in our annual report on Form 10-KSB filed on September 6, 2006.

Use of Estimates

In preparing financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the balance sheet date and the reported amounts of revenue and expenses during the reporting period. Material estimates that are particularly susceptible to significant change in the near term relate to the carrying values of investments, inventory, intangible assets, and other receivables. Actual results could differ from those estimates.

Stock-Based Compensation

Prior to our current fiscal year which began June 1, 2006, the Company accounted for its stock-based compensation plans under Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees". The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-based Compensation" to stock-based employee compensation for the three and nine months ended February 28, 2006:

| | Three Months Ended February 28, 2006 | Nine Months Ended February 28, 2006 |
|---|---|---|
| Net (loss) as reported | $ (364,062) | $ (1,248,162) |
| Stock Based Employee Compensation expense Included in net (loss) | -- | 4,769 |
| Deduct : total stock-based employee compensation expense determined under fair value method for all awards | (175,746) | (239,476) |
| Pro forma net (loss) | $ (539,808) | $ (1,482,869) |
| Basic shares outstanding | 8,215,210 | 8,215,143 |
| Diluted shares outstanding | 8,215,210 | 8,215,143 |
| Earnings per share as reported: | | |
| Basic | $ (.04) | $ (0.15) |
| Diluted | $ (.04) | $ (0.15) |
| Earnings per share, pro forma | | |
| Basic | $ (.07) | $ (0.18) |
| Diluted | $ (.07) | $ (0.18) |

The fair value of each option grant is estimated as of the grant date using the Black-Scholes option pricing model. The following weighted average assumptions were used to value the options granted in the quarter ended August 31, 2005:

| | |
|---|---|
| Risk-free interest rate | 4.00% |

| | |
|---|---|
| Expected dividend yield | None |
| Expected life of options | 10 years |
| Expected volatility | 40% |
| Weighted-average grant-date fair value | $.51 |

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123(R), "Share-Based Payment, an Amendment of FASB Statements No. 123 and 95." SFAS No. 123(R) establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services or incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments. SFAS No. 123(R) requires public entities to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions) and recognize the cost over the period during which an employee is required to provide service in exchange for the award. The Company adopted SFAS No. 123 (R) on its effective date, commencing with the quarter beginning June 1, 2006.



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Adoption of SFAS No. 123(R) did not have a material effect on our financial statements for the nine month period ended February 28, 2007 as there were no unvested options outstanding at June 1, 2006 and no options were granted in the nine month period ended February 28, 2007.

Earnings Per Share

Basic loss per share is computed by dividing net loss by the weighted average number of shares of common stock outstanding during the period. For the three and nine month periods ended February 28, 2007 and February 28, 2006, the effect of stock options and warrants was anti-dilutive; therefore, they were not included in the computation of diluted loss per share. The number of shares issuable upon the exercise of outstanding stock options and warrants that were excluded from the computation as their effect would be anti-dilutive, were 3,774,049 and 2,551,800 for the nine months ended February 28, 2007 and February 28, 2006, respectively.

Cash and Cash Equivalents

Cash and cash equivalents as of February 28, 2007 represents cash on hand of $294 in checking and savings accounts, $86,434 in money market accounts and an investment in a debt security with a carrying value of $2,712,496 that had a maturity of less than 90 days at the date of purchase.

Inventory

Inventory represents purchasing of long lead SOCRATES® system components to further expand to a thirty-two beam system. Inventory is accounted for at lower of cost or market and on the first-in first-out basis.

Revenue and Cost Recognition

Our contracts with the United States government are cost-reimbursable contracts that provide for a fixed profit percentage applied to our actual costs to complete the work. These contracts are subject to audit and adjustment by our government customer, and are subject to cost limitations as provided by the contract.

For these contracts, fee revenue is recorded at the time services are performed based upon actual project costs incurred and include a reimbursement for general, administrative, and overhead costs and the base fee. The general, administrative, and overhead costs are estimated periodically in accordance with government contract accounting regulations and may change based on actual costs incurred subject to approval. Revenue may be adjusted for our estimate of costs that may be categorized as disputed or unallowable as a result of cost overruns or the Government audit process.



Contract costs include all direct material, labor and subcontracting costs. General and administrative costs are charged to expense as incurred. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions and estimated profitability and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined. Revenue related to claims is recorded at the lesser of actual costs incurred or the amount expected to realized.

Intangible Assets

Intangible assets consist of patent costs. Amortization expense for the nine months ended February 28, 2007 and February 28, 2006 was $15,441 and $12,975 respectively. Amortization expense for each of the next five years is currently expected to be approximately $22,000.

Note 2. Investments in Marketable Securities:

A summary of investments as of February 28, 2007 is as follows:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized (Losses) | Fair Value |
|---|---|---|---|---|
| Available for Sale | | | | |
| Mutual bond funds | $ 1,250,000 | $ -- | $ -- | $ 1,250,000 |

Note 3. Stock Options:

Options may be granted from time to time for shares of common stock as determined by the Board of Directors, subject to any applicable shareholder approval requirements. The stock options granted to date were vested and exercisable as of May 31, 2006. The options are exercisable up to ten years from the date of vesting.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model. Expected volatilities are based on the historical volatility of the Company's stock and other factors. The Company uses historical data to estimate option exercise and employee termination within the valuation model. The expected term of options granted represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.



A summary of option activity under the plan as of February 28, 2007, and changes during the nine month period then ended is presented below:

| Options | Shares (000) | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (years) | Aggregate Intrinsic Value ($000) |
|---|---|---|---|---|
| Outstanding at May 31, 2006 | 1,886,100 | $ 3.58 | 8.99 | $-- |
| Granted | -- | -- | -- | -- |
| Exercised | -- | -- | -- | -- |
| Forfeited or expired | <31,251> | 6.00 | -- | -- |
| Outstanding at February 28, 2007 | 1,854,849 | $ 3.55 | 8.39 | $0 |
| Exercisable at February 28, 2007 | 1,854,849 | $ 3.55 | 8.39 | $0 |

Note 4. Warrants:

We have 1,919,200 warrants outstanding as of February 28, 2007. These warrants are comprised of 1,514,200 warrants with an exercise price of $3.30, 270,000 with an exercise price of $3.60, and 135,000 warrants with an exercise price of $5.40 which were issued as part of a public offering that expire January 29, 2009.

Note 5. Other Receivables:

Other receivables represent retained fees on government contracts which represent up to a 15% payment hold back against billable fees. We do not expect to receive payments for these other receivables in the next year and consider this account a long term asset. The summary below compares the balances for other receivables as of February 28, 2007 and May 31, 2006.

| | February 28, 2007 | May 31, 2006 |
|---|---|---|
| Retained Fee | | |
| Phase III Socrates | $ -- | $ 96,673 |
| Phase IV Socrates | 30,460 | -- |
| Other | 424 | -- |
| Total | $ 30,884 | $ 96,673 |

Note 6. Other Current Assets

:

As of February 28, 2007, other current assets were $177,767 compared to $264,750 as of May 31, 2006. This net decrease of $86,983 is primarily due the reduction of approximately net $182,000 for prepaid legal fees for a class action suit, resulting from a cash receipt from our insurance company of $122,000, credit memos to our three law firms of $82,000, offset by additional charges that will be due from the insurance company in the amount of $36,000. In addition, there were increases of approximately $66,000 for prepaid refurbishment expense for the SOCRATES system at the Denver International Airport both covered by our insurance policy and approximately a $14,000 increase to prepaid insurance and prepaid taxes.



Note 7 : Contingency

Our liquidity to date has primarily been provided by revenue from our government contracts and proceeds from the sale of our equity securities. Our funded contract backlog for our Phase IV Contract was $0 since December 31, 2006. As of February 28, 2007, our cash and investments were $4,049,224 and we anticipate that we will fund a substantial portion if not all of our operating expense and technology and development costs from our own cash and investments on hand through the end of our fiscal year May 31, 2007.

Our cash projections do not consider additional funding from our $9.815 million SOCRATES® research and development contract received September 15, 2005 beyond the current task order funding of $3.104 million. In order to receive additional contract funding the government must request and we must submit a cost and technical proposal for review and approval of the government. As of the date of this report, we have not received a request for an additional task order and do not have a projection as to a date for additional task orders. Further task orders will require additional government funding for further research and development of SOCRATES® technology or AWSM, of which there is $0 funding specified in the current federal budget for its fiscal year ending September 30, 2006 and

$0 in the FAA budget for fiscal year ending September 30, 2007. We are actively pursuing various sources of funding but there can be no assurance as to whether or when we will obtain such funding. Lack of and further delays in obtaining additional government contract or other outside funding will require us to internally fund our operation by drawing upon our cash and investments. Without such internal funding, we would be unable to carry on and complete further research and development of SOCRATES® technology or AWSM, as well as our other technologies. However, our own resources are limited and may not be sufficient to complete the research, development and testing that is necessary to commercialize any of our technologies. Our inability to obtain further government or private funding for research, development and testing of our technologies would have a material adverse affect upon our financial condition and our ability to maintain our operations

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

Cautionary Statement Pursuant to Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995:

Except for the historical information presented in this document, the matters discussed in this quarterly report on Form 10-QSB for the three and nine month period ended February 28, 2007 or otherwise incorporated by reference into this document, contain "forward-looking statements" (as such term is defined in the Private Securities Litigation Reform Act of 1995). These statements are identified by the use of forward-looking terminology such as "believes", "plans", "intend", "scheduled", "potential", "continue", "estimates", "hopes", "goal", "objective",



expects", "may", "will", "should" or "anticipates" or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy that involve risks and uncertainties. The safe harbor provisions of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended, apply to forward-looking statements made by us. We caution you that no statements contained in this Form 10-QSB should be construed as a guarantee or assurance of future performance or results. These forward-looking statements involve risks and uncertainties, which include risks and uncertainties associated with, among other things, the outcome of pending class action litigation alleging violations of federal securities laws, the outcome of Massachusetts federal district court litigation initiated by Analogic Corporation concerning our TIICM™ technology, whether the government will implement wake vortex advisory system at all or with the inclusion of a SOCRATES® wake vortex sensor, the impact of competitive products and pricing, limited visibility into future product demand, slower economic growth generally, difficulties inherent in the development of complex technology, new products sufficiency, availability of capital to fund operations, research and development, fluctuations in operating results, and these and other risks are discussed in the "Known Trends, Risks and Uncertainties" section Management's Discussion and Analysis of Financial Conditions and Results of Operations of this Form 10-QSB. The actual results that we achieve may differ materially from any forward-looking statements due to such risks and uncertainties. These forward-looking statements are based on current expectations, and, except as required by law, we assume no obligation to update this information whether as a result of new information, future events or otherwise. Readers are urged to carefully review and consider the various disclosures made by us in this Form 10-QSB and in our other reports filed with the Securities and Exchange Commission that attempt to advise interested parties of the risks and factors that may affect our business.

Overview

Our operations to date have been funded substantially by U.S. Congressional appropriations resulting in four successive sole source contracts with agencies of the federal government for research, development, and testing of our SOCRATES® wake vortex sensor and related work pertaining to a wake vortex advisory system, sometimes referred to as WakeVAS, that National Aeronautics and Space Administration (NASA) has been developing. We estimate the appropriations to the Federal Aviation Administration (FAA) totaled approximately $9.6 million in U.S. fiscal years ended September 30, 1997 through September 30, 2000 for research and development of our SOCRATES® wake vortex sensor; and appropriations to NASA for research and development of our SOCRATES® wake vortex sensor totaled approximately $18.5 million in U.S. fiscal years ended September 30, 2001 through September 30, 2005. To date the total government appropriations for SOCRATES® and WakeVAS is approximately $28.1 million. From these amounts, we have received four contracts aggregating approximately $19.8 million in funding. As of February 28, 2007, we have recognized an aggregate of approximately $19.8 million of contract revenue. Our current SOCRATES® government contract backlog as of February 28, 2007 is $0. The balance of the government appropriations from 1997 to 2005 of approximately $8.3 million has funded the FAA and NASA program management and technical participation in the development of our SOCRATES® wake vortex sensor and WakeVAS system technology.



We have entered into these contracts with the Volpe National Transportation Systems Center of the U.S. Department of Transportation (Volpe). Volpe funds our contracts when, as, and if it and other sponsoring federal agencies approve a statement of work and specific task orders under the statement of work. When funded, we invoice the federal government monthly based on our direct costs, including overhead and general and administrative plus a fixed fee for that month and typically receive payment by electronic wire transfer within two weeks of invoicing. Certain costs, such as lobbying, product development, and business development expenses that are not allowable under these contracts, research and development costs we incur over certain cost caps set by the U.S. government, costs incurred while our contracts are not funded, or costs deemed unreasonable, and hence unrecoverable, by the government are not reimbursable under our government contracts and have been funded primarily by proceeds of our equity offerings. All of our government contracts and funding are subject to the requirements of the Federal Acquisition Regulations.

On September 25, 2005, we received our fourth successive contract from Volpe in the aggregate amount of approximately $9.8 million to continue research, development and testing of our SOCRATES® technology. The initial task order funding under this new contract provided approximately $1.7 million of contract funding to us and was dated September 25, 2005. On January 27, 2006 we received our second task order under this new contract which provided approximately $1.4 million of additional funding.

The second task order funding was completely expended as of December 31, 2006. Our ability to generate additional revenue under our Phase IV contract is subject to further U.S. government funding and the issuance of additional task orders. If additional funding becomes available under the Phase IV contract, the remaining amount of $6,711,086 can be funded with new task orders which generally require less administrative effort than a new contract award. At this time we are not projecting any additional funding in our current fiscal year which ends May 31, 2007.

There are no stipulated earmarks or other sources of funding in the U.S. FY 2006 and FY2007 budget for further testing and development of SOCRATES®-based technology. We are continuing to explore additional funding opportunities from potential sources in the NASA and/or U.S. Department of Transportation (DOT) budgets and from the private sector.

The table below represents the U.S. Government funding to date for our four SOCRATES® contracts.

| SOCRATES® Phase | Contract Number | Contract Funding | Period of Performance |
|---|---|---|---|
| I | DTRS-57-97-C-00042 | $3,019,355 | From June 1, 1997<br>To July 31, 1999 |
| II | DTRS-57-99-D-00074 | $6,062,948 | From August 27, 1999<br>To December 31, 2003 |
| III | DTRS-57-03-D-30024 | $7,617,165 | From November 1, 2003<br>To October 15, 2005 |
| IV | DTRT-57-05-D-30115<br>Task Order No: T0001 | $1,695,029 | From September 15, 2005<br>To March 31, 2006 |
| | DTRT-57-05-D-30115<br>Task Order No: T0002 | $1,409,025 | From January 27, 2006<br>To December 31, 2006 |
| Total contract funding to date | | $19,803,522 | |

We believe that the federal government has indicated a long-term interest in the development of a wake vortex avoidance system and our SOCRATES® wake vortex sensor for potential inclusion in such a system. In 2003, the federal government began an initiative to develop the Next Generation Air Traffic System (NGATS). NGATS is intended to be a more flexible and automated system "capable of meeting up to two or three times the current capacity demand by the year 2025". The federal government's Joint Planning and Development Office (JPDO) oversees a coalition of government agencies which are involved in developing NGATS, including the U.S. Departments of Transportation, Defense, Homeland Security and Commerce and the FAA, NASA and White House Office of Science and Technology Policy. These organizations have developed a "roadmap" that defines the technologies that must be developed and implemented in order to achieve the goals of NGATS. Among those technologies are systems which allow for enhanced safety as well as increased throughput of air traffic at airports through reduction of the applied spacing between aircraft. This reduction will be accomplished, in part, "based on ground-based wake vortex detection and prediction," expected to be implemented and tested in the U.S. fiscal years 2008-2011 timeframe.

To our knowledge, the FAA has no plans to apply sufficient resources to the development of a WVAS incorporating both prediction and detection in time for implementation and testing in the timeframe called for by the NGATS roadmap. This disparity between the roadmap and FAA budgeting has been noted in Congressional communications to the FAA and we expect will be the subject of future discussions between the FAA and Congress although there can be no assurances as to the pace or outcome of any such discussions.



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From June 1, 1997, to the present we have advanced the SOCRATES® concept through various research and development milestones and now have a 16 beam SOCRATES® sensor installed at Denver International Airport where we anticipate the sensor will undergo further testing through approximately May 31, 2007. The expenses for the continued testing are expected to be paid for with corporate funds.

We believe that the WakeVAS system we are assisting to develop, which may incorporate the SOCRATES® wake vortex sensor, will be the first system that could include both wake vortex prediction and detection. However, there is currently no funding for further research and development of SOCRATES® technology or WakeVAS in the current FAA budget for its fiscal year ending September 30, 2007 and we received no such funding in the federal budget for its fiscal year ended September 30, 2006. We are pursuing other sources of government and private funding for research and development of SOCRATES® technology, but can make no assurances of whether or when we will obtain such additional funding. Our inability to obtain or any delay in such contract funding for research and development of SOCRATES® and/or WakeVAS technology from the federal government or other sources has delayed further research, development and testing and could eliminate or delay achievement of profitability, if any, create a substantial strain on our liquidity, resources and product development, and have a material adverse effect on the progress of our SOCRATES® technology research and development and our financial condition.

We also are pursuing development of an airborne collision and ground proximity warning system for aircraft that we refer to as UNICORN™. We believe that UNICORN™ may have application to manned and unmanned air vehicles operated for a variety of private and governmental purposes. As of February 28, 2007, our direct cumulative research and development expenses for UNICORN™ total approximately $1,312,000. During August 2005 we tested a UNICORN™ prototype antenna in a proof-of-principle test. The data collected from this test has been analyzed and the results were favorable. We engaged a placement agent to assist us in pursuing a tax advantaged joint venture financing to complete the research and development of our UNICORN™ technology for general aviation aircraft and unmanned aerial vehicles (UAV's). In support of this effort we have incurred cumulative expenses for legal fees, placement agent fees, market assessment and business planning expenses of approximately $380,000. The original engaged placement agent agreement has been cancelled and we are pursuing other means, [which may include finding a new placement agent?], to secure this financing. The market assessment was prepared by Charles River Associates based in Boston, Massachusetts. There can be no guarantee or assurance that we will complete a financing to fund our UNICORN™ research and development. If we do not complete such a financing, we will continue to pursue private and federal government funding to develop UNICORN™ UAV applications. In addition, we have been pursuing the application of UNICORN™ technology to unmanned air vehicles (UAV's). On April 2, 2007, we received an Air Force contract to begin the research and development of UNICORN™ for UAV's. This contract is for $99,316 and has a nine month period of performance.



During our fiscal year 2005, we also began the exploratory development of a third major technology initiative called TIICM™ (Tactical Integrated Illuminating Countermeasure) in conjunction with Sanders Design International (SDI), a New Hampshire company. TIICM™ is intended to provide a low cost yet highly effective shield of protection for airliners against the threat of certain terrorist-launched missiles. In April 2004, we executed a ten year Teaming Agreement with SDI under which we would be the prime contractor on development of countermeasure technologies to protect aircraft from shoulder-fired missiles. As of February 28, 2007 our cumulative independent research and development expense for TIICM™ is approximately $697,000. We have entered into additional arrangements with SDI pursuant to which we have applied for a new patent on TIICM™ with SDI and would have joint ownership of any resulting patent. In the Department of Homeland Security budget for U.S. fiscal year 2006, Congress added $10 million for the investigation of emerging technology for the protection of civil aircraft against terrorist missile threats. SDI expects to receive $1 million in funding from an extension to their Phase II Small Business Innovative Research (SBIR) contract with the U.S. Air Force for further TIICM™ research and development. This funding is expected to come half from the U.S. Air Force and half from the Department of Homeland Security. FST expects to participate in a subcontract from SDI to support this further development, test and maturation of TIICM™ technology, although there can be no assurance of whether or when we will receive such contract or the amount of such subcontract. There can be no assurance that any new patents on TIICM™ will be issued, or that we will derive any revenue or profit from TIICM™, nor any expectation that we will receive any government or commercial funding for TIICM™. Prospects for development of TIICM™ may be adversely influenced by pending litigation that Analogic Corporation, which previously had supported development of TIICM™, brought against us and SDI.

We have experienced significant losses since our inception. The loss for the nine months ended February 28, 2007 was $1,942,160. Losses for the fiscal years ending May 31, 2006, 2005, and 2004 were $2,257,559, $1,411,644 and $424,214, respectively. The net loss for our fiscal year ended May 31, 2004 was caused primarily by two factors: (1) rate ceilings during the first six months, and (2) unallowable expenses under our government contract. The loss for the fiscal year ending May 31, 2005 was caused by: (1) unallowable expenses under our government contract, (2) expenses during a partially unfunded period, and (3) unrecoverable and/or unabsorbed operating expenses. The loss for the fiscal year ended May 31, 2006 and the nine months ended February 28, 2007 was caused by (1) unallowable expenses under our government contract, (2) contract cost overruns, (3) unrecoverable and unabsorbed operating expenses, and (4) corporate research and development expenses. The unrecoverable expense category represents general and administrative expenses, primarily legal expenses and independent research and development expense which we believe are necessary but are significantly higher compared to prior years and may be considered unreasonable by the Defense Contract Audit Agency for a company our size.

We also remain subject to the risk of further delay, reduction or elimination in federal contract funding. However, it is our view that the elimination of rate ceilings is a significant improvement to our historical contract terms.



Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based on our financial statements that have been prepared according to accounting principles generally accepted in the United States of America. In preparing these financial statements, we are required to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. We evaluate these estimates on an on-going basis. We base these estimates on historical experiences and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions. Our management has discussed these estimates and assumptions with our finance and audit committee. Subjective judgments may have a material impact on our financial statements, including recoverability of inventory and intangible assets and insurance claims receivable.

In addition, Federal Acquisitions Regulations require that, among other things, our reimbursable costs are reasonable. We have analyzed our actual overhead rate and general administrative rate for the nine months ended February 28, 2007. We believe all component costs have been ordinary and necessary but that government auditors may consider some of our selling, general and administrative expenses for the nine months ended February 28, 2007 unreasonable for a company our size. For rate setting purposes, we have excluded approximately $700,000 for potential unrecoverable selling, general and administrative, research and development, and certain other expenses, i.e., unabsorbed operating expenses, for the nine months ended February 28, 2007. Since there is a degree of subjectivity in the judgment of what levels of cost are reasonable, we can make no assurance that the government will not require further adjustments.

Results of Operations

FLIGHT SAFETY TECHNOLOGIES, INC.

Statements of Operations and Other Comprehensive Income (Loss)
For the Three and Nine Months Ended February 28, 2007 and February 28, 2006

| | Three Months 2007 | Three Months 2006 | Nine Months 2007 | Nine Months 2006 |
|---|---|---|---|---|
| Contract Revenues | $ 182,712 | $ 914,268 | $1,442,739 | $3,652,238 |
| Cost of Revenues | 334,193 | 469,332 | 1,182,293 | 2,171,700 |
| Gross Profit | (151,481) | 444,936 | 260,446 | 1,480,538 |

| | | | | |
|---|---|---|---|---|
| Operating Expenses: | | | | |
| Research and development | 22,535 | 175,018 | 49,463 | 853,198 |
| Selling, general and administrative | 596,942 | 686,816 | 2,283,362 | 1,812,297 |
| Depreciation and amortization | 27,023 | 24,015 | 81,069 | 86,825 |
| Total operating expenses | 646,500 | 885,849 | 2,413,894 | 2,752,320 |
| Loss from Operations | (797,981) | (440,913) | (2,153,448) | (1,271,782) |
| Other Income (Expense) | | | | |
| Interest income | 59,093 | 83,051 | 192,308 | 213,095 |
| Gain (Loss) on investments available for sale | -- | -- | 12,025 | (170,875) |
| Loss before provision for income taxes | (738,888) | (357,862) | (1,949,115) | (1,229,562) |
| Provision for income taxes | (17,925) | 6,200 | (6,955) | 18,600 |
| Net Loss | (720,963) | (364,062) | (1,942,160) | (1,248,162) |
| Other Comprehensive Income (Loss) | | | | |
| Unrealized gains (loss) on investments | -- | (1,348) | 12,025 | (64,191) |
| Less reclassified adjustments | -- | -- | (12,025) | 170,875 |
| Comprehensive Loss | $(720,963) | $(365,410) | $(1,942,160) | $(1,141,478) |
| Net Loss Per Share | | | | |
| Basic and diluted | $ (.09) | $ (.04) | | |