FLIGHT SAFETY TECHNOLOGIES INC
Form 10KSB
September 07, 2006

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 May 31, 2006
Commission file number 000-33305

FLIGHT SAFETY TECHNOLOGIES, INC.

(Name of small business issuer in its charter)

Nevada	95-4863690
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
28 Cottrell Street, Mystic, Connecticut 06355	(860) 245-0191
(Address of principal executive offices and Zip Code)	(Issuer's telephone number)

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

(Title of class)	(Name of each exchange on which registered)
Common Stock, par value $0.001 per share	AMEX
Common Stock Purchase Warrants	AMEX

Securities registered under Section 12(g) of the Exchange Act: None

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 issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Check if there is no 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. o

Registrant's revenues for its most recent fiscal year: $3,869,962

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

The aggregate market value of the common stock held by non-affiliates of the registrant, based on the last sale price of $2.58 per share on September 5, 2006, as reported on the American Stock Exchange, was approximately $18,152,663. In determining the market value of non-affiliate voting stock, shares of common stock beneficially owned by each executive officer and director have been excluded. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

There were 8,215,210 shares of common stock outstanding as of August 28, 2006.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement relating to the registrant's 2006 Annual Meeting of Stockholders are incorporated by reference into Part III of this Report.

Transitional Small Business Disclosure Format (Check one): Yes o ; No x

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Preliminary Note: 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 annual report on Form 10-KSB for the fiscal year ending May 31, 2006 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-KSB 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 WVAS 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" in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of this Form 10-KSB. 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-KSB 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.

SOCRATES®, UNICORN™ and TIICM™ are trademarks of ours. This Form 10-KSB also refers to trademarks and trade names of other companies and organizations.

Unless the context indicates otherwise, all references in this Form 10-KSB to "we," "our," "us," "the company," "FST" and "Flight Safety" refer on a consolidated basis to Flight Safety Technologies, Inc, a Nevada Corporation, or to our former subsidiary, Flight Safety Technologies Operating, Inc., a Delaware corporation (sometimes referred to as "FSTO") that was merged into FST on June 27, 2003.

PART I

Item 1. Description of Business.

Overview

We are developing three new technologies designed to enhance aviation safety and efficiency. These technologies include SOCRATES®, UNICORN™, and TIICM™.

SOCRATES® is a technology we are developing into a ground-based laser acoustic sensor to detect and track wake vortices at airports.

UNICORN™ is a technology we are developing into an airborne radar for collision avoidance and ground proximity warning.

TIICM™ is a technology we are developing into a system to protect commercial and military aircraft against terrorist threats from heat seeking missiles.

We are developing SOCRATES® to be a component for possible inclusion in a wake vortex avoidance system, known as WVAS, that the National Aeronautics and Space Administration (NASA) has described. We believe that our SOCRATES® wake vortex sensor, upon completion and deployment in concert with other components of WVAS, can potentially;

Improve the safety of aircraft arrivals and departures at airports;
Safely increase runway landing and takeoff rates;
Reduce passenger delays; and
Generate substantial cost savings for the airline industry and other airport users.

An initial "proof of principle" test of our SOCRATES® wake vortex sensor was conducted at JFK International Airport in May 1998. We subsequently completed testing of an expanded and improved SOCRATES® technology, using a NASA Boeing 757 as the source aircraft, at Langley Air Force Base in December 2000. On September 13, 2003, we completed a three-week test of an improved SOCRATES® wake vortex sensor at Denver International Airport. Based upon our analysis of initial data, this test demonstrated a major increase in the capability and reliability of the sensor. Building upon these three tests, we further developed our SOCRATES® wake vortex sensor and tested a 16-beam configuration during September, 2005. Likewise, based on our analysis of initial data, this 2005 test demonstrated a major increase in the capability and reliability of our SOCRATES® wake vortex sensor.

We have conducted research, development, and testing of our SOCRATES® wake vortex sensor in conjunction with Lockheed Martin Corporation pursuant to a ten-year teaming agreement dated May 1, 1997, under which we are the prime contractor. Under the teaming agreement, we

generally have subcontracted to Lockheed Martin Corporation significant participation in the development and assembly of the hardware components of our SOCRATES® wake vortex sensor, including the low-power laser generators, reflectors, and receivers. Lockheed Martin Corporation personnel also have supported the operation of this equipment during tests of our SOCRATES® wake vortex sensor through various stages of development to date, have been developing software used in analyzing test data and have worked with us in analyzing test data itself. Our payments to Lockheed Martin Corporation under the teaming agreement have averaged approximately $1,300,000 and 36% of our average annual contract revenue for FY2006 and FY2005. We currently are discussing with Lockheed Martin certain unresolved issues in our relationship and there can be no assurance our relationship with Lockheed Martin Corporation will continue after expiration of the teaming agreement in May 2007.

We also are developing a collision avoidance and ground proximity warning system for aircraft based on our technology referred to as UNICORN™. On September 13, 2002, we received a frequency assignment from the Federal Communications Commission for experimental purposes and development of UNICORN™ technology which is subject to renewal under certain conditions on September 1, 2006. In August 2003, we signed a contract with Georgia Tech Applied Research Corporation, (GTARC), under which GTARC commenced work on the construction of our UNICORN™ technology antenna elements. We also contracted with Microwave Solutions, Limited, in England to produce the radar electronic modules. An initial proof-of-principle tower based test of UNICORN™ technology antenna elements, one of the major components of a potential UNICORN™ system, was conducted in August of 2005. We are pursuing the possibility of raising research and development funding for UNICORN™ through a tax-advantaged research and development partnership.

During fiscal year 2006, we continued pursuing a third new technology initiative, called TIICM™ (Tactical Integrated Illuminating Countermeasure), for protection of military or commercial aircraft against certain shoulder-launched terrorist missile threats. We believe that TIICM™ technology may be a more cost-effective solution to this problem than competing military systems which are currently being funded by the government. We are working on development of TIICM™ technology with Sanders Design International, a small innovative defense contractor based in New Hampshire. We have incurred costs of approximately $685,000 for TIICM™ technology research and development thus far, not including business development, legal and government affairs and. Depending on the results of our research,

development and testing, we may invest further in TIICM™ technology.

We contracted with Georgia Tech Applied Research Corporation (GTARC) to utilize their government approved simulation model to subject TIICM™ technology to over 100,000 simulated missile attacks on a Boeing 737 aircraft. Preliminary results of this analysis were encouraging. There can be no assurance as to, if, or when, we will be able to successfully develop TIICM™ technology, that our TIICM™ technology efforts will result in any contracts, or revenues, or profits, to us, or that our relationships with other companies to develop TIICM™ technology will be successfully formalized, or that there will be any revenues, or profits, to us.

Since our inception, our primary source of funding has been four successive contracts with the federal government aggregating approximately $19.8 million for research, development and testing of our SOCRATES® wake vortex sensor. We have not had any revenues from commercial sales of SOCRATES®, UNICORN™ or TIICM™ technologies, and we may not realize such sales for several years. We have incurred cumulative losses of $6,553,440 as of May 31, 2006, which we have funded with the proceeds of three equity offerings. We will need additional funds to complete our future research and development of these technologies and may need to raise additional capital for this purpose. We may consider and execute from time to time strategic investments, acquisitions or other transactions that we believe will benefit us and complement our current operations, technologies, and resources.

History

We are a Nevada corporation that was incorporated in May 2001 under the name of Reel Staff, Inc. to provide staffing services to film, video and television production companies. Prior to a share exchange in September 2002 with the shareholders of Flight Safety Technologies, Inc., (FSTO), a Delaware corporation, our operations were minimal and our revenues were not material. Our organization and limited operations primarily were funded by (i) a contribution of services from shareholders, who in return were issued common stock and (ii) $12,075 of proceeds from a private placement of our common stock to investors. In October 2001, we registered these shares with the SEC under the Securities Act of 1933 pursuant to an SB-2 Registration Statement, as amended, that we filed with the SEC in order to make our shares of common stock eligible for public trading. Since that time, we have filed periodic reports with the SEC pursuant to the Securities Exchange Act of 1934.

FSTO, which originally commenced operations in 1997 as a Wyoming corporation, was co-founded by two of our directors, Samuel A. Kovnat and Frank L. Rees. In consideration of his shares, Mr. Rees assigned his SOCRATES® and UNICORN™ patents to FSTO. In consideration of Mr. Kovnat's shares, he contributed intellectual capital and services to FSTO. Advanced Acoustic Concepts, Inc. and Leonard Levie were also founders of FSTO. Advanced Acoustic Concepts, Inc. received shares of common stock in FSTO in consideration of its release of any claims on the UNICORN™ patent contributed by Mr. Rees, and Mr. Levie received his shares in consideration of contributing his business experience, and developing an initial business plan for FSTO. As a result, FSTO owned patents on our SOCRATES® and UNICORN™ technologies.

FSTO received the original contract with the federal government for the research and development of our SOCRATES® technology in connection with its potential application to wake vortices on May 29, 1997. On November 3, 2000, FSTO completed a private placement of preferred stock arranged by Spencer Trask Securities Incorporated which resulted in net proceeds to us of approximately $1,500,000. In consideration of this placement, Spencer Trask

Intellectual Capital Company, LLC received shares of our common stock and warrants to acquire our preferred stock, as well as placement agency fees and reimbursement of certain costs. All of the preferred shares and warrants for preferred shares were converted, respectively, to common stock and warrants for common stock pursuant to their terms as a result of the share exchange.

In September 2002, we consummated a share exchange with the stockholders of FSTO. The share exchange was facilitated by Dunhill Venture Partners Corp., a Vancouver, British Columbia based firm. Dunhill Venture Partners Corp. also facilitated a private placement of a total of 283,334 shares of our common stock and 283,334 warrants, each for one share of our common stock, to Wakefield Holdings Corp. and Nicholson Group Limited, pursuant to Regulation S promulgated by the SEC, which resulted in aggregate proceeds to us of $1.7 million. In January 2003, we registered these shares and the warrant shares with the SEC pursuant to an SB-2 Registration Statement. During July and August 2003, the warrants were exercised, and we issued the 283,334 warrant shares, generating $1.7 million in aggregate proceeds to us. As a result of the share exchange, we discontinued our previous operations and changed our name to Flight Safety Technologies, Inc., FSTO changed its name to Flight Safety Technologies Operating, Inc., FSTO became our subsidiary and stockholders of FSTO acquired approximately 53% of our outstanding common stock. In June 2003, FSTO merged into us, and we now own the patents on and are continuing the development of our SOCRATES® and UNICORN™ technologies.

During February 2004, we sold 1,514,300 units at $6.00 per unit in a registered underwritten secondary public offering. Each unit consisted of two shares of our common stock and a warrant to purchase one share of our common stock at $3.30 a share. Separate trading of the common shares and warrants began on March 1, 2004. We received net proceeds from this offering of approximately $7.6 million.

Principal Concepts Under Development and Market Opportunities

SOCRATES® Wake Vortex Sensor

Whenever an aircraft is in flight, its wings and wing flaps create wake vortices, which are similar to horizontal tornadoes trailing back from the wing tips. If a second aircraft encounters these vortices, even several minutes after the first plane has passed, its pilot's control of the aircraft may be compromised. To address these hazards, the Federal Aviation Administration (FAA) has established requirements for increased spacing between airplanes as they land and take off. The spacing translates into more time in the air, which results in flight delays and increased fuel and flight crew costs. Requirements for even larger spacing for aircraft trailing the new, very large Airbus A380 are anticipated to further exacerbate wake-related flight delays.

Our initial focus for SOCRATES® has been the development of a wake vortex sensor to detect, locate and track wake vortex turbulence, based on the sound radiated by the turbulence. The sensor design includes a low-power laser transmitter and receiver, a laser beam reflector and special optical and electronic components to translate changes in laser transmissions caused by their interaction with sound radiation from the vortices, and determine the presence and location of wake vortex turbulence. While our present focus is on air turbulence created by aircraft wakes, we believe that with future research and development our SOCRATES® technology may also enable the detection of various hazardous atmospheric phenomena, such as wind shear and microbursts.

In September 2003, we completed a three-week test of improved SOCRATES® technology that operated with four laser beam sensors at Denver International Airport. This test was part of a NASA-sponsored wake acoustics test and is part of NASA's continuing efforts to improve aviation safety and capacity. A principal purpose of this NASA-sponsored test was to acquire adequate field data using carefully calibrated microphone arrays to confirm the scientific basis for the use of sound in detecting, tracking, and characterizing wake vortices created by arriving aircraft. Our SOCRATES® wake vortex sensor recorded acoustic emissions generated by wake vortices from a variety of aircraft, including Boeing 737 and 757 aircraft, Airbus A319 and A320 aircraft, and even smaller regional jets. The system recorded these emissions directly above the SOCRATES® sensor array from wake vortices approximately 500 feet above ground level. We performed a preliminary analysis of the results and provided a "quick-look" report to NASA and Volpe in October 2003. Our final report, in summary, showed an 81% detection rate of wake vortices by our SOCRATES® sensor array. The results were from three weeks of collected data and approximately 750 flyover data sets.

Following the 2003 Denver test, we received government funding to upgrade and expand our SOCRATES® wake vortex sensor from a 4-beam to a 16-beam system and test this expanded sensor in September of 2005. Our goal in the test of our expanded sensor was to detect and track wake vortices at ranges up to 1,100 meters and altitudes up to 250 meters above the sensor site. Our preliminary analysis from this September 2005 Denver International Airport test leads us to conclude our expectations for the SOCRATES® wake vortex sensor capabilities are justified.

Based on testing to date, we believe our SOCRATES® technology has the potential to provide sensor information for a ground-based wake vortex avoidance system, or WVAS, to detect dangerous air turbulence from wake vortices in the vicinity of airports. NASA and the FAA have described the integration of other components of WVAS including advanced weather sensors, prediction software for both the vortex movement and the persistence of existing wind conditions, adaptive spacing procedures and communication links between the sensors and the air traffic control facilities. We plan to produce an emulation of an operational SOCRATES® wake vortex sensor working within a conceptual WVAS at Denver International Airport in late 2006 or early 2007.

Upon successful completion of further development, testing and FAA approval, our sensor could become a component in a WVAS to be used by air traffic controllers to establish safe separation between either arriving or departing aircraft. In furthering this development, we plan to integrate the sensor with other potential components of a WVAS, and develop operating protocols for use of our sensor with other WVAS components by air traffic controllers and pilots. As described by the FAA, such components may include advanced weather sensors, prediction software for both the vortex movement and the persistence of existing wind conditions, adaptive spacing procedures and communication links between the sensors and the air traffic control facilities. Some of these components are under development and the integration process will be technically challenging.

In June 2003, the FAA approved a long-term mission needs statement and related investment plan that contemplates expenditures by FAA and NASA of $206 million during the period running from U.S. fiscal year 2003 through 2010 on wake vortex detection research and development. The FAA investment plan includes deployment of a prototype WVAS and culminates in development of wake turbulence capability at selected airports and integration with controller tools. The mission needs statement may not be approved at all necessary levels of the federal government, and the federal government may not provide the funding required to complete the mission needs statement. This funding must be annually requested by the FAA, authorized and approved by Congress, and approved by the President. There is no assurance as to what amount of contract funding, if any, we will receive in connection with the mission needs statement to complete the research, development, and testing of our SOCRATES® wake vortex sensor for inclusion in a WVAS. To date, the FAA has not requested Congress to appropriate funds for this purpose. The FAA has assigned an overall moderate to high risk rating to the implementation of this program due to technical unknowns and risks associated with getting controllers and pilots to accept a ground or flight deck based system.

We believe the FAA's substantial investment in addressing the problems associated with wake vortex turbulence and its issuance of the long-term mission needs statement for wake turbulence indicate its awareness that there is a growing need in the aviation industry for technologies to combat the wake vortex problem. There are many other participants and constituencies that could have an interest in the deployment and financing of our sensor as part of a WVAS. For example, the International Federation of Airline Pilots Associations, (IFALPA), which represents over 100,000 pilots worldwide and is recognized as the global voice of pilots on both labor and aviation safety issues, officially states a requirement for vortex monitoring in any system designed to safely reduce the current wake vortex-related spacing requirements. The busier airports, which are typically owned and operated by state and local authorities, also have a natural interest in increasing airport safety and efficiency. Airlines also could benefit from installation of a WVAS, which we believe could include our SOCRATES® wake vortex sensor, through increased safety and efficiencies and a reduction in fuel costs attributable to delays.

WVAS still faces technical hurdles and, furthermore, must be accepted by a variety of constituencies involved in the

National Airspace System, including, but not limited to, air traffic controllers and pilots. We can make no assurance whether or when the FAA will implement WVAS, either with or without our SOCRATES® wake vortex sensor. At this time, we do not know if we can successfully complete development of our SOCRATES® wake vortex sensor, if the federal government will provide the funding required to complete our plan, if we will successfully implement the plan and testing, or if the government will implement WVAS at all or with the inclusion of our SOCRATES® wake vortex sensor.

UNICORN™ Technology

We also have pursued development of an airborne collision and ground proximity warning system we refer to as UNICORN™. As of May 31, 2006, our cumulative research and development expenditure on UNICORN™ was approximately $1,280,000. During August, 2005 we tested a UNICORN™ prototype antenna in a proof-of-principle test. The data collected from this test is currently being analyzed and we are considering how best to proceed with plans for the eventual commercialization of UNICORN™.

Our original plan for UNICORN™ technology was to provide a low-cost, combined, collision alerting and ground proximity warning capability for general aviation aircraft, including private, business and smaller regional and commercial aircraft. Since fiscal year ended May 31, 2004, we also have been investigating the potential application of our UNICORN™-based "see and be seen" collision avoidance technology for unmanned air vehicles, (UAVs), including military, other government, and commercial operations. Accelerating government requirements for UAV applications in the U.S. domestic airspace, together with higher than anticipated development costs, production cost estimates based on information we obtained from ongoing product development that significantly exceed our initial projections, and increasing competition in the general aviation market for UNICORN™-like products, have caused us to pursue the utilization of a tax-advantaged research and development partnership for our UNICORN™ technology.

Our UNICORN™ technology is based on a unique implementation of radar technology in an airborne system to detect and track aircraft and detect the ground below and ahead of the airplane. Although further research, development and testing are required, we believe that fixed element antennas on the top and bottom of the aircraft could provide full spherical coverage for detection of collision threats up to four nautical miles away. UNICORN™ would alert pilots to a potential collision threat by both audible and visual means, and the locations of the threat aircraft would be shown on either an existing or dedicated cockpit display.

Following a recommendation of support from the FAA in September 2002, the Federal Communication Commission (FCC) issued us an Experimental Radio Station License facilitating UNICORN™ antenna development on either of two frequencies: 5145 MHz in the FAA aviation band and 3650-3700 MHz in the non-aviation band. These frequencies may be used at any of three designated locations in the eastern U.S. until September 1, 2006. We have since filed for an extension of the approval by application and we have undertaken the steps necessary to expand our testing to an airborne test range and to use additional frequencies in the airborne radar band.

We acquired the UNICORN™ technology from Advanced Acoustic Concepts, Inc., (AAC), in January 2000 in exchange for shares of our common stock. We have agreed to pay AAC a lump sum payment of $150,000 after we receive revenues from sales of UNICORN™ products of $1,000,000. In addition, we will pay to AAC a continuing royalty of 3% of all net sales of UNICORN™ products thereafter.

We have initiated very preliminary discussions with the federal government about the possible use of UNICORN™ technology on Unmanned Air Vehicles, or UAV's, to perform the "see and avoid" function. There is increasing interest on the part of civil and military authorities in operating UAVs in parts of the National Airspace System other than military restricted areas. These operations could not take place unless the collision safety issue is addressed. We believe that our UNICORN™ technology may have the potential to meet this emerging need.

A UNICORN™-based UAV collision avoidance system would contain an antenna and computerized electronics that are similar in concept to those used in the UNICORN™ general aviation products we have been developing. However, the audio alert and visual display would be replaced by a computerized interface with the onboard flight control system of the UAV. This interface would override the flight control system to cause the UAV to take evasive maneuvers required to avoid collision with other aircraft and/or ground-based objects such as terrain and obstructions.

TIICM™ Tactical Integrated Illumination Countermeasure Technology

TIICM™ is intended to provide a low-cost, highly effective shield to protect airliners against the threat of some terrorist missiles. TIICM™ represents a new concept that provides special infrared sources mounted on wings, tail sections and along the bottom of the aircraft fuselage sections, together with particular sequencing of these illumination sources to both attract certain missile seeker elements and "spoof" certain threat missile guidance systems.

We are developing TIICM™ in conjunction with Sanders Design International (SDI), a New Hampshire company. In April, 2004, we executed a 10-year Teaming Agreement with SDI under which we would be the prime contractor with respect to development of counter-technologies for certain anti-aircraft heat seeking shoulder fired missiles. Under additional arrangements with SDI, we filed an application for and would share with SDI ownership of the

TIICM™ patent if the patent application results in an award of a new patent. A prior patent on an earlier technology was awarded to SDI in February, 2004, which is the subject of a 2003 license agreement between SDI and Analogic Corporation, a company located in Peabody, Massachusetts. This licensing agreement may limit our ability to earn revenue from TIICM™. The legal significance of the Analogic license agreement as it relates to our Teaming Agreement with SDI and TIICM™ patent application is the subject of a lawsuit pending in federal court in Boston, Massachusetts which asserts, among other things, that FST and SDI infringed Analogic's rights under the 2003 license agreement by entering the 2004 Teaming Agreement.

There can be no assurance that TIICM™ will ultimately be successful in achieving a cost-benefit advantage against more well established and mature competing technologies, or that we will receive any significant revenues or profits

from TIICM™.

Sales and Marketing

SOCRATES® Wake Vortex Sensor

If and when we successfully complete research, development, and testing of our SOCRATES® wake vortex sensor and the WVAS, our goal is to obtain FAA approval of and support for the use of our SOCRATES® wake vortex sensor in a WVAS implementation due to the growing demand for cost-effective ways to improve airport safety and capacity and the advantages of our technology over existing alternatives. Our strategies for selling SOCRATES®-based products for use in airports will include:

Closely coordinating with the FAA, which would acquire and deploy the WVAS, including SOCRATES® technology, at United States airports,

Assisting airports to apply for the allocation of airport improvement grants to acquire WVAS,

Targeting the busiest U.S. airports, followed by airports in other countries, with a campaign that includes informational seminars and direct marketing,

Publicizing the advantages of our SOCRATES® wake vortex sensor in promoting advanced air safety and airport productivity to members of the U.S. Congress, aircraft manufacturers, commercial airlines, and air travel trade industry groups, and

Soliciting FAA funding for the establishment of "beta sites" for the installation of SOCRATES® at select U.S. airports (Anchorage, Miami, Louisville, Memphis and Dallas Fort Worth).

UNICORN™ Airborne Radar Technology

During the past two years, we have become increasingly aware of an emerging requirement to integrate collision avoidance capability into the flight control systems of unmanned aerial vehicles (referred to by the government as "see-and-avoid" for UAV's). We believe such a technology may in the future be able to penetrate the aviation industry when integrated with cooperative surveillance techniques.

The present market for UAVs is almost entirely military and very limited and the potential of an expanded market is unclear. However, the potential uses of UAV's over the next 20-30 years could include:

Traditional military surveillance
Customs/Border patrol surveillance
Harbor/port surveillance
Regional and local law enforcement
Fire fighting
Crop dusting

It has been estimated as many as 20,000 UAV's may be employed in the US domestic airspace over the next 20 years. If, as, and when we can complete the development and flight testing of a UAV UNICORN product, we intend to market UNICORN to:

Government - Military and Department of Homeland Security users
UAV Manufacturers
Commercial UAV users

There can be no assurance that we will successfully complete the development of UNICORN, integrate UNICORN into UAV systems, or gain any market acceptance for UNICORN as a UAV or general aviation product.

TIICM™ Sales and Marketing

If, as, and when, we can successfully complete sufficient research, development and testing and gain government approval of TIICM™ technology, we would anticipate initiating a market strategy to include:

Working closely with U.S. government officials to gain their support for marketing TIICM™ to the U.S. airline fleet which consists currently of about 6,800 aircraft.

Targeting an initial market of the smaller commercial aircraft currently employed, and the US airline companies that operate them.

Working with the aircraft manufacturers such as Boeing and Airbus Industries.
Working with the Air Transport Association (ATA).
Working with the U.S. Congress to provide appropriation funding for TIICM™.
Extending the potential market to include international airliners.
Extending the potential applicability of TIICM™ for use in military aircraft uses.

There can be no assurance that TIICM™ will achieve any market acceptance in any of these uses.

Competition

SOCRATES® Wake Vortex Sensor

The aviation and airport safety business is very competitive. We expect competition in hazardous weather applications and wake vortex detection and warning sensors and systems to intensify as air travel and airport congestion continue to increase worldwide, and as public scrutiny of aviation safety heightens. Although we are not aware of any other company or organization developing technologies such as ours, other alternatives exist and it is possible that others could develop or improve their systems to achieve similar results. We may face competition from established companies in the aviation systems marketplace, which are currently providing or developing technologies and products such as Low Level Windshear Alert Systems, airborne and ground-based Doppler Radar, Lidar, Laser Doppler Velocimetry, Terminal Doppler Weather Radar, and the Minix Winglet. These companies include Allied Signal/Honeywell, Coherent Technologies, Northrop Equipment Corp., Raytheon Corp., Christian Hugues and others. The chart below describes these alternative ground-based technologies.

Technology	Description	Limitations	Mfr.	Status
Low Level Windshear Alert Systems ("LLWAS")	Detects windshears & microbursts 50 - 150 feet above ground Alerts triggered when wind speeds are not consistent at multiple wind sensors around airport and runways	Limited range Can be unreliable Early warning insufficient since only detects windshear in immediate vicinity	Raytheon	Commercially Available
Doppler Radar	Airborne and ground-based systems Detect speed and location of disturbances by reflecting electromagnetic waves off atmospheric particles	Often misses small phenomena Limited detection range Need airborne rain or ice crystals to reflect radar Insufficient early warning	Raytheon	Limited Installations
Lidar ("Light detection and rangefinding")	Airborne and ground-based systems Detect disturbances by measuring the reflection and scattering of a powerful infrared pulse Greater accuracy than radar	Does not work in clouds Insufficient early warning	Coherent Technologies, Inc.	Commercially Available
Laser Doppler Velocimetry	Airborne and ground-based systems Measures the speed and location of disturbances by analyzing the frequencies of two laser beams reflected off atmospheric particles Greater range and accuracy than radar	Does not work in clouds Insufficient early warning	None	Research and Development
Terminal Doppler Weather Radar ("TDWR")	Ground-based system Detects hazardous atmospheric conditions in the airport terminal area Detects changing winds to give early warning of hazardous conditions Highly reliable and accurate	Requires tall towers to be installed 8-12 miles away from airport, which are expensive and often encounter resistance from residential communities Does not capture small phenomena like wake vortices	Raytheon	Limited Installations

Minix Winglet	Solid, light wing tip attachment made of Kevlar and carbon Eliminates vortex pressure around wings Increases speed Reduces fuel consumption Allows aircraft to carry more weight	May not address the dominant wake vortices created by the outer tip of the main flap May adversely affect the lift-to-drag ratio of the aircraft May not work as advertised	None	Research and Development

We believe our SOCRATES® wake vortex sensor may offer many advantages over the products and technologies provided by these competitors, although further research, development, and testing are needed to complete our sensor and make it operational. We believe that if, as and when our SOCRATES® wake vortex sensor is fully developed and operational, these advantages may position us to penetrate the market, particularly for a ground-based wake vortex sensor. We believe the advantages of a wake vortex sensor based on our SOCRATES® technology will include:

Greater reliability in foggy or cloudy weather conditions that often impede lidar-based systems;
Superior accuracy, even for small disturbances other systems often miss;
Earlier warning of potential hazards;
No need for large atmospheric particles to detect disturbances; and
Greater cost-effectiveness and easier implementation.

UNICORN™ Technology

Competition for the "see and avoid" function in the UAV community consists of optical and radar systems. An optical system under development by Defense Research Associates (DRA) provides fairly accurate azimuth and elevation to the target during visual weather conditions but little or no range information. The field of view is also limited to plus or minus 110 degrees in azimuth and plus or minus 20 degrees in elevation. A 35 GHz radar system tested on a UAV by the Navy is quite limited in range and also has the limited field of view.

We believe that, if and when, successfully developed and tested, our UNICORN™-based products may offer potential advantages over currently available alternatives in the UAV and, later, the general aviation market for small aircraft. Current competition in the general aviation market includes the following:

Technology	Description	Limitations	Mfr.	Status
Transponder	9900BX Traffic Advisory System	Only detects transponders;	Ryan	In production

		Relatively expensive		
Transponder	Monroy ATD-200	Only detects transponders; Does not provide time to collision	Monroy	In production
Transponder	L3-Goodrich Skywatch Traffic Advisory System	Only detects transponders	Goodrich	In production
TCAS	Traffic Alert & Collision Avoidance System	Only detects transponders; Relatively expensive	Rockwell and Honeywell	In production
Transponder	KTA 970 TCAS I	Only detects transponders Relatively expensive	Honeywell	In production
Transponder and terrain data base	KMH 980 TCAS/EGPWS	Only detects transponders Uses terrain database Relatively expensive	Honeywell	In production

General

Our ability to compete successfully in the market for air safety products will depend on our success in:

- Completing on a timely basis the research and development, prototyping, testing, and production of our SOCRATES®, UNICORN™-based, and TIICM™ products;
- Obtaining FAA approval of our SOCRATES® wake vortex sensor and UNICORN™ and TIICM™ products;
- Marketing and selling our products to airports, the FAA, airlines and manufacturers and owners of general aviation aircraft;
- Promoting awareness and acceptance of our products among members of the U.S. Congress and other government officials, aircraft manufacturers, commercial airlines, and air travel industry trade groups; and
- Developing and/or acquiring additional technologies and products to meet the changing needs of the aviation industry.

Many of our potential competitors have longer operating histories, greater name and brand recognition and substantially greater financial, technical, marketing, management, service, support, and other resources than we do.

Therefore, they may be better able to respond than we can to new or changing requirements, technologies, or standards. We may not be able to compete successfully against current or future competitors, and the competitive pressures may materially and adversely affect our business, operating results and financial condition.

Government Funding

A substantial amount of our time and expenditures have been spent on the research, development and testing of our SOCRATES® wake vortex sensor. A substantial portion of our funding for research and development contracts of our SOCRATES® wake vortex sensor has and is expected to continue to come from appropriations of the federal government. These appropriations, from which we have been allocated an aggregate of approximately $19.8 million in contract funding to date, have been earmarked by Congress for the procuring federal agencies, FAA and NASA, for funding, monitoring and administering the development of SOCRATES® technology to enhance airport and airline safety.

For U.S. fiscal year 2004, an additional $5 million NASA appropriation specifically for continued work on project SOCRATES® was enacted into law. In November, 2004 our sponsoring agencies released $3,237,310 of these funds and approved an extension of our contract, statements of work, and appropriate work orders which included a major airport test of the expanded 16 beam SOCRATES® wake vortex sensor at Denver International Airport (DIA), conducted in September 2005.

For U.S. fiscal year 2005, the government appropriated $5 million to NASA specifically for additional research and development work on SOCRATES® technology and data analysis of the test at DIA of the 16 beam SOCRATES® system. For U.S. fiscal year 2006, the government did not appropriate earmarked funds for SOCRATES® technology. We anticipate further funding, of which there can be no assurance, will occur at the direction of the FAA as part of its budgetary process.

On December 12, 2003, Public Law 108-176 was passed authorizing FAA funding for U.S. fiscal years 2004 through 2007. The new law, designated "Vision 100 - Century of Aviation Reauthorization Act," authorizes the FAA to spend from its $2 billion Air Navigation Facilities & Equipment annual budget such funds as may be necessary in each of the next four U.S. fiscal years for the development and analysis of a wake vortex advisory system (WVAS). We are aiming to complete development of our SOCRATES® wake vortex sensor for inclusion in any such system which NASA is currently developing. The government must successfully test and accept WVAS and our SOCRATES® wake vortex sensor for integration into any such system. Funds can only be made available for each year by appropriation legislation and pursuant to contract and work orders between us and the procuring federal agency. To

date, the FAA has not requested Congress to appropriate funds for this purpose. There is no assurance as to whether or when these funds will be appropriated, how these funds will be allocated among us, participating agencies, and other parties presently or in the future involved in development of the wake vortex advisory system, or what portion of these funds, if any, we ultimately may receive.

Upon successful completion of research and development of our SOCRATES® wake vortex sensor, we would also depend upon the FAA for procurement and installation of WVAS including our sensor in U.S. airports. In June 2003, the FAA approved a long-term mission needs statement that contemplates expenditures by FAA and NASA of $206 million during the period running from U.S. fiscal year 2003 through 2010 on wake vortex detection research and development, including deployment of a prototype WVAS and culminating in development of wake turbulence capability at selected airports and integration with controller tools. The mission needs statement may not be approved at all necessary levels of the federal government and the federal government may not provide the funding required to complete the mission needs statement, which must be annually requested by the FAA, authorized and approved by Congress, and approved by the President. There is no assurance as to what amount of contract funding, if any, we will receive in connection with the mission needs statement. To date, the FAA has not requested Congress to authorize or appropriate these funds. The FAA has assigned an overall moderate to high risk rating to this program due to technical unknowns and risks associated with getting controllers and pilots to accept a ground or flight deck, or both, based system.

The U.S. government may terminate our government contract at any time if it determines such termination is in the best interests of the government or may terminate, reduce or modify it because of budgetary constraints or any change in the government's requirements. Furthermore, the federal government may hold, reduce or eliminate future funding for research and development of our SOCRATES® wake vortex sensor or WVAS as a result of a reduction in support or opposition from supervising agencies, changes in budgetary priorities or decisions to fund competing systems or components of systems. If this occurs, it will reduce our resources available for research and development of our proprietary technologies, new products or enhancements to our SOCRATES®, UNICORN™ or TIICM™ technologies and to market our products. Reduction of funding from the federal government could delay achievement of or increases in profitability, create a substantial strain on our liquidity, resources, and product development, and have a material adverse effect on the progress of our research and development and our financial condition.

Our Intellectual Property and Technology

SOCRATES® Technology

We intend to rely on a combination of patent protection, trademark protection, trade secret protection, copyright protection, and confidentiality agreements to protect our intellectual property rights. We have received a United States patent relating to our SOCRATES® technology (US Patent No. 6,034,760 issued on March 7, 2000). We have received patents on the SOCRATES® technology in Australia, Canada, China, Democratic Peoples Republic of Korea, Israel, New Zealand and Norway. We have corresponding patent applications, based upon the United States application, for a patent on our SOCRATES® technology pending in Japan, Saudi Arabia, Turkey, and the European Patent Organization. There can be no assurance any patent will issue from these pending applications. We also may apply to federally register various copyrights in our software and documentation with the United States Copyright Office and abroad.

Our SOCRATES® technology patent, includes two fundamental claims: a method claim and an apparatus claim. The method claim covers a laser device that produces an optical beam, directs that beam into the atmosphere and measures

the effect of sound waves on the beam as an indicator of hazardous weather conditions that have produced those sound waves in the atmosphere. The apparatus claim covers the apparatus for performing the method claim. Both of these claims cover systems that are mounted either directly on the front of an aircraft or on the ground adjacent to a runway.

We have taken certain steps to preserve our rights in our SOCRATES®-related technologies under our contracts with the federal government. However, as under any government funded research and development contract, the Federal Acquisition Regulations provide that the federal government may have paid-up rights to use our SOCRATES®-related technologies under certain circumstances.

On April 26, 2004, in conjunction with the renewal of a nondisclosure agreement, we were advised by Lockheed Martin Corporation that it owns a certain patent which predates our SOCRATES® patent and, according to Lockheed Martin Corporation, contains some intellectual property related to our SOCRATES® patent. We are conducting further discussions with Lockheed Martin Corporation on this issue and other unresolved issues. We cannot predict or provide any assurance on the outcome of these discussions and whether any outcome will be satisfactory to us.

Also, our SOCRATES® trademark is now registered on the Principal Register, having Registration No. 2,967,386.

UNICORN™ Technology

We also have received a United States patent relating to our UNICORN™ technology (US Patent No. 6,211,808 issued on April 3, 2001 and re-issued as U.S. Patent No. RE 39,053). We have received patents on the UNICORN™ technology in Australia, Canada, and New Zealand. We have corresponding patent applications, based upon the United States application, for a patent on our UNICORN™ technology pending in Japan and the European Patent Organization. However, there can be no assurance any patent will result from these pending applications. We also may apply to federally register various copyrights in our software and documentation with the United States Copyright Office and abroad.

Our UNICORN™ technology patent includes claims which cover a collision avoidance airborne radar system. The invention incorporates a unique antenna design which provides three-dimensional surveillance to provide collision warning as well as ground proximity and terrain avoidance alerting to the pilot.

It selectively uses each microwave sector as a way to determine the direction of any received radar echo from another close-by aircraft or the ground below or terrain ahead that poses a potential threat within that coverage. Controlling the integration of these functions permits detection of several almost simultaneous potential threat encounters. The claims cover any UNICORN™-based system whose antenna may be fabricated in an equivalent way and subdivided for low drag-profile mounting above and below the fuselage of an aircraft. The UNICORN™ system is fully independent, in that, unlike most other collision avoidance systems in current use, it does not require that other aircraft in the vicinity have a cooperative warning system such as a transponder beacon.

Also, we re-applied for federal protection of our UNICORN™ trademark in the United States in August, 2006.

TIICM™ Technology

We filed a Patent Application with the United States Patent and Trademark Office in September, 2005 for TIICM™ (Tactical Integrated Illuminating Countermeasure) technology in conjunction with Sanders Design International (SDI), (a New Hampshire company). A corresponding Patent Cooperation Treaty (PCT) application was filed in January 2006. TIICM™ is intended to provide a low-cost, highly effective shield to protect airliners against the threat of certain terrorist missiles. Under our arrangement with SDI, we will share ownership of the TIICM™ patent, if the application results in a new patent award. There can be no assurance that any patent will result from our TIICM™ filing. We filed an application to obtain a federal trademark on TIICM™ in July, 2005. The application was approved but is being opposed by a party which claims it holds similar marks and it is too early to assess the outcome.

Government Approval and Regulations

The airport and airline industry is subject to extensive government oversight and regulation. To introduce a product for commercial sale, we must successfully complete research, development, and testing of the product and obtain necessary governmental approvals for installation of our SOCRATES® wake vortex sensors in airports or installation of UNICORN™ technology in small aircraft. For our SOCRATES® wake vortex sensors, the FAA must commission WVAS for use in the National Airspace System. As UNICORN™ and TIICM™ technologies are airborne systems, they must be FAA certified for use on aircraft. Any factor that delays or adversely affects this process, including delays in development or difficulty in obtaining federal government approval of the product, could adversely affect our business, financial condition, or results of operations.

Additionally, as a result of receiving funding from the federal government, our business and operations are subject to numerous government laws and regulations. In the near term, and for so long as we receive funding from the federal government, we will be subject to many procurement and accounting rules and regulations of the federal government. We are also subject to periodic audits by the Defense Contract Audit Agency. To date, we have completed seven audits and reports have been issued to our government customer which have stated that we are performing in full accordance with Federal Acquisitions Regulations.

Employees

As of May 31, 2006, we had nine full-time and two part-time employees. Our employees are not members of a union, and we are not aware of any efforts on their part to form or join a union. We believe that our relationship with our employees is good.

Item 2. Description of Property.

Our primary offices, located in Mystic, Connecticut, are leased on an annual basis at a monthly rate of $2,750. We also utilize satellite office space that we lease or use on a month to month basis pursuant to the following arrangements with the following parties: (i) Baltimore, Maryland leased from our executive vice president and director, Frank L. Rees, at $500 per month; (ii) Austin, Texas space provided without charge by our president and director, William B. Cotton; and (iii) North Kingston, Rhode Island leased from The Meadows Professional Office Park on an annual basis at a monthly rate of $1,200; and (iv) Lancaster, Pennsylvania space provided without charge by our Senior Engineer Robert L. Cooperman. We believe that our facilities are adequate to satisfy our projected requirements and that additional space will be available if needed.

Item 3. Legal Proceedings.

Several lawsuits have been filed in the United States District Court for the District of Connecticut, by purchasers of our common stock naming us, certain of our executive officers and directors, and certain underwriters, who sold shares of our common stock to the public, as defendants. The suits assert claims under Section 10b of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder and under Section 11 of the Securities Act of 1933 and breach of fiduciary duty. The complaints allege, among other things, that we failed to disclose material details from a report circulated by Volpe in October 2001, which generally concerned the timetable and our prospects for achieving operational viability of the SOCRATES® wake vortex sensor. The plaintiffs seek unspecified damages on behalf of a purported class of purchasers of our securities.

On June 28, 2006, we received notice that Analogic Corporation filed a lawsuit against us and our CEO and Sanders Design International (SDI) and its principals over perceived contractual interference relating to development of TIICM™ countermanpads technology on which SDI and we have filed a joint patent application. Analogic's lawsuit, among other things, asserts that we and SDI infringed Analogic's rights under a 2003 license agreement between SDI and Analogic by entering into a teaming agreement in 2004 and filing the joint patent application on TIICM™ in 2005.

We firmly believe that the claims contained in these lawsuits are without merit and intend to conduct a vigorous defense in these matters. These lawsuits could be time-consuming and costly and could divert the attention of our management. These lawsuits or any future lawsuits filed against us could harm our business.

As previously reported, we learned in December 2003 that the United States Securities and Exchange Commission staff was conducting an informal investigation which appeared to be looking into certain analyst reports about us, and

our press releases. The Commission staff did not assert that we acted improperly or illegally and we voluntarily cooperated fully with the staff's informal investigation. We believe that we acted properly and legally with respect to these analyst reports and our press releases. On August 22, 2006, we received notification from the Commission that it has terminated its informal investigation of us with no enforcement action recommended.

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

None.

PART II

Item 5. Market for Common Equity and Related Stockholder Matters.

Market Information

On January 30, 2004, our common stock became eligible to trade on the American Stock Exchange, or AMEX, under the symbol FLT. As of August 18, 2006, we had 8,215,210 shares of common stock outstanding, of which 6,469,972 shares trade on the AMEX. The following chart shows the high and low sales price of our common stock for each of our fiscal quarters as quoted on the AMEX:

Fiscal Quarter	High	Low
8/31/04	$1.82	$1.00
11/30/04	$1.88	$1.31
2/28/05	$1.74	$1.12
5/31/05	$2.09	$1.30
8/31/05	$1.64	$1.21
11/30/05	$3.90	$1.35
2/28/06	$3.19	$2.00
5/31/06	$2.88	$2.05

As of May 31, 2006, we had 93 record holders of our common stock, as reflected on the books of our transfer agent. A significant number of shares were held in street name and, as such, we believe that the actual number of beneficial owners is significantly higher.

Equity Compensation Plans

We adopted the 2005 Stock Incentive Plan in October 2005. Under the terms of the 2005 Plan, all of our employees, directors, consultants and advisors are eligible to be granted options, restricted stock awards, or other stock-based awards. Under the 2005 Plan, a total of 1,500,000 shares of our common stock are available for issuance, of which 246,600 shares remain available for future awards as of May 31, 2006. In addition, the shareholder vote that approved the 2005 Plan also approved previous awards totaling 570,000 shares of our common stock.

The Compensation Committee of our board of directors, in its discretion, selects the person(s) to whom stock based awards may be granted, the time or times at which such awards shall be granted, the number of shares subject to each such grant, and the term of the award. The exercise price of options granted under the 2005 Plan is determined by the Committee at the time the options are granted but may not be less than 100% of the fair market value of the common stock on the date such option is granted; provided, however, the exercise price of an incentive stock option granted to a 10% or greater shareholder may not be less than 110% of the fair market value of the common stock on the date such option is granted.

Options granted under the 2005 Plan expire no later than ten (10) years from the date of grant; provided that in the case of an incentive stock option granted to a 10% shareholder, the term of the option may be no more than five (5) years from the date of grant. No option may be exercised after the expiration of its term.

The table below provides information relating to our equity compensation plans as of May 31, 2006.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under compensation plans (excluding securities reflected in first column)
Equity compensation plans approved by shareholders	1,823,600	$3.50	246,400
Equity compensation plans not approved by security holders	62,500	6.00	(a)

(a) The equity compensation plan not approved by shareholders is comprised of individual common stock option agreements issued to directors, prior to the adoption of the Company's current stock option plan. The common stock options vest between one and three years of the date of issue and expire within three years of the vesting date. The exercise prices of the current outstanding options are $6.00 per share.

Options issued to:	Number of options	Exercise price	Vesting dates	Expiration dates
Directors	62,500	$6.00	2003-2005	2006-2008
Total issued	62,500			

Dividends

We have never declared or paid any cash dividends on our common stock. For the foreseeable future, we intend to retain any earnings to finance the development and expansion of our business, and we do not anticipate paying any cash dividends on our common stock. Any future determination to pay dividends will be at the discretion of our Board of Directors and will be dependent upon then existing conditions, including our financial condition and results of operations, capital requirements, contractual restrictions, business prospects, and other factors that our Board of Directors considers relevant.

Recent Sales of Unregistered Securities

There have been no sales of unregistered securities within the last three years which would be required to be disclosed pursuant to Item 701 of Regulation S-B except the following:

On September 1, 2002, as part of a share exchange with FSTO, as Reel Staff, Inc., we issued 8,211,728 shares of common stock to stockholders of FSTO in return for a 96.54% ownership interest in FSTO. On June 27, 2003, we issued 294,129 shares of our common stock to remaining shareholders of FSTO as a result of FSTO being merged into us pursuant to Delaware and Nevada law. The securities issued in the share exchange and the merger were exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended, because this issuance was not a public offering.

On September 1, 2002, prior to the share exchange with FSTO, as Reel Staff, Inc., we issued 850,000 common shares and 850,000 warrants, each warrant to purchase one of our common shares. The shares and warrants were issued in a private placement in reliance upon Regulation S under the Securities Act of 1933. The common shares were issued at a price of $2.00 per share, resulting in aggregate proceeds of $1,700,000 and net proceeds after costs of issuance of approximately $1,500,000. We subsequently registered these shares and the shares underlying the warrants pursuant to an SB-2 Registration Statement that became effective February 19, 2003. As of August 31, 2003, all such warrants had been exercised, resulting in additional aggregate proceeds of $1,700,000.

Item 6. 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 annual report on Form 10-KSB for the fiscal year ended May 31, 2006 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-KSB 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-KSB. 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-KSB 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 current operations 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 WVAS, that National Aeronautics and Space Administration (NASA) is developing. We estimate the appropriations to the Federal Aviation Administration (FAA) totaled approximately $9.6 million in U.S. fiscal years ending 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 ending September 30, 2001 through September 30, 2005. To date the total government appropriations for SOCRATES® and WVAS is approximately $28.1 million. From these amounts, we have received four contracts aggregating approximately $19.8 million in funding. As of May 31, 2006, we have recognized an aggregate of approximately $18.6 million of contract revenue with $0.1 million in contract receivable as of May 31, 2006. Our current SOCRATES® government contract backlog is approximately $1.2 million. 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 WVAS.

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 new funding.

The federal budget for U.S. FY 2006 does not contain any further stipulated earmarks for testing and development of SOCRATES®-based technology. We are continuing to explore additional funding from potential sources in the NASA and/or U.S. DOT budgets for U.S. FY 2007 and beyond.

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 To July 31, 1999
II	DTRS-57-99-D-00074	$6,062,948	From August 27, 1999 To December 31, 2003
III	DTRS-57-03-D-30024	$7,634,616	From November 1, 2003 To October 15, 2005
IV	DTRT-57-05-D-30115 Task Order No: T0001	$1,695,029	From September 15, 2005 To Present
	DTRT-57-05-D-30115 Task Order No: T0002	$1,409,025	From January 27, 2006 To Present
Total contract funding to date		$19,820,973	

Our ability to generate additional revenue under our Phase IV contract after we have expended the current task order funding of $1,409,025, which is expected to support our current level of effort through approximately September 30, 2006, is subject to further U.S. Government funding and the issuance of additional task orders. The Phase IV contract was awarded on September 25, 2005 for $9,815,140 and 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, if additional funding is available under this contract. We believe 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. However, there is currently $0 for further research and development of SOCRATES® technology or WVAS in the current federal budget for its fiscal year 2006. We are pursuing other sources of funding but can make no assurances of whether or when we will obtain additional contract funding for research and development of SOCRATES® technology. Our inability to obtain or any delay in contract funding from the federal government 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 research and development and our financial condition.

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 in fiscal year 2007. Our current contract Task Order No. T0002 statement of work includes system engineering and development of a concept of operations for a functional emulation of a WVAS and preparation for additional field testing. During the 2006 New Years Eve holiday period there was a break-in and vandalism at our SOCRATES® sensor test site at Denver International Airport. A number of items were stolen from the SOCRATES® sensor van as well as from the U.S. Department of Transportation Volpe trailer on site. Damage to SOCRATES® sensor optoelectronics also occurred as a result of fire retardant chemicals being sprayed by the perpetrators. As of May 31, 2006 the SOCRATES™ sensor has not been fully restored but we believe the sensor will be ready for additional testing by September 2006. There can be no guarantee or assurance of a complete restoration. We have insurance coverage for the damage to the SOCRATES™ sensor.

We also are pursuing development of an airborne collision and ground proximity warning system we refer to as UNICORN™. We believe that UNICORN™ may have application to unmanned air vehicles operated for a variety of private and governmental purposes. As of May 31, 2006 the cumulative research and development expense for UNICORN™ is approximately $1,280,000. During August 2005 we tested a UNICORN™ prototype antenna in a proof-of-principle test. The data collected from this test is currently being analyzed. We currently are reviewing and exploring partnering opportunities for development of UNICORN™.

During 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 May 31, 2006 our cumulative independent research and development expense for TIICM™ is approximately $685,000. 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 contract with the U.S. Air Force for further TIICM™ research and development. This funding will come half from the U.S. Air Force and half from the Department of Homeland Security. FST expects to negotiate a subcontract from SDI to support this further development, test and maturation of TIICM™ technology. 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 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, (2) expenses during a partially unfunded period, and (3) unrecoverable expenses. The loss for the fiscal year ended May 31, 2006 was caused by (1) unallowable expenses, (2) contract cost overruns, (3) unrecoverable 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.

Our Phase III and Phase IV government contracts do not include rate ceilings. If the government deems our allowable expenses to be reasonable, of which there can be no assurance, the absence of rate ceilings should eliminate or reduce a significant source of losses in previous years. We will continue to incur certain unallowable expenses or allowable expenses the government deems unreasonable. 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. At this point in our operations, subjective judgments do not have a material impact on our financial statements except as discussed in the next paragraph.

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 fiscal year ended May 31, 2006. We believe all component costs have been ordinary and necessary but that government auditors may consider some of our selling, general and administrative expenses and our independent research and development expense for UNICORN™ technology for the fiscal year ended May 31, 2006 unreasonable for a company

our size. For rate setting purposes, we have excluded approximately $1,000,000 for potential unrecoverable selling, general and administrative, research and development, and certain other expenses, i.e., unabsorbed operating expenses, for the fiscal year ended May 31, 2006. 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.

Our financial statements and notes thereto include an item for "Other Receivables" that is described therein. Other receivables includes recoverable rate differences resulting from the difference between the current general and administrative rate compared to our provisional rate. For the fiscal years ended May 31, 2006 and 2005 this difference was $0 and $291,000, respectively.

Results of Operations

FLIGHT SAFETY TECHNOLOGIES, INC.

Statements of Operations and Comprehensive Income (Loss)
For the Years Ended May 31, 2006 and May 31, 2005

	May 31, 2006	May 31, 2005
Contract Revenues	$ 3,869,962	$ 3,310,871
Cost of Revenues	2,369,311	2,233,773
Gross Profit	1,500,651	1,077,098
Operating Expenses		
Research and development	1,054,278	557,137
Selling, general and administrative	2,592,745	2,001,871
Depreciation and amortization	108,001	125,660
Total Operating Expenses	3,755,024	2,684,668
Loss From Operations	(2,254,373)	(1,607,570)
Other Income (Expense)		
Interest income	283,951	223,586
Loss on investments available for sale	(262,337)	--
Loss before provision for income taxes	(2,232,759)	(1,383,984)
Provision for income taxes	24,800	27,660
Net Income (Loss)	(2,257,559)	(1,411,644)
Other Comprehensive Income (Loss)		
Unrealized (Loss) on investments	(98,314)	(44,522)
Less reclassification adjustment for loss included in net income	262,337	--
Comprehensive Income (Loss)	$(2,093,536)	$(1,456,166)
Net Loss Per Share		
Basic and diluted	$ (.27)	$ (.17)
Weighted Average Number of Shares Outstanding		
Basic and diluted	8,215,168	8,217,971

Revenues

. To date, our revenues have consisted almost entirely of revenues earned from our four successive SOCRATES® wake vortex sensor research and development contracts with the federal government.

Contract revenue for the fiscal year ended May 31, 2006 was $3,869,962 compared to $3,310,871 for the fiscal year ended May 31, 2005. The $559,091 increase for the fiscal year ended May 31, 2006 compared to the prior year was due primarily to the increased subcontractor, direct labor and consultant costs to test the 16 beam SOCRATES® system during the three months ended November 30, 2005 at Denver International Airport. Contract revenue for fiscal year ended May 31, 2006 and 2005 also included $142,608 and $39,508, respectively for engineering services we provided to companies conducting research and development in the maritime industry. The revenue increase of $103,100 is part of the overall revenue increase of $559,091.

Costs of Revenues

. Subcontractor, consultant and direct labor expenses comprise our costs of revenues. Costs of revenue for the fiscal year ended May 31, 2006 was $2,369,311 or 61.2% of revenue, compared to $2,233,773 or 67.4% of revenue for the fiscal year ending May 31, 2005. The increase in cost of revenues is primarily due to increased cost to test the 16 beam SOCRATES® system in September and October 2005 at Denver International Airport.

When our government contract is funded, charges to direct costs do not generally negatively impact our operating results because each contract covers its own direct costs. However, during periods when our government contract is not funded or if the actual direct cost of a specific task order exceeds its budgeted funding and the government is not willing to reallocate direct costs between task orders, any such costs we may incur are cost overruns, which are not reimbursable and must be funded from our own resources.

Research and Development

. Our research and development expense for the fiscal year ended May 31, 2006 was $1,054,278 compared to $557,137 for the fiscal year ended May 31, 2005. The increase in research and development expenses of $497,141 for the fiscal year ended May 31, 2006 was primarily due to the increase of approximately $565,000 for project TIICM™ (Tactical Integrated Illumination Countermeasure) for fiscal year end of May 31, 2006 compared to May 31, 2005 and a decrease of $70,000 in the cost of research and development of our UNICORN™ technology for fiscal year ended May 31, 2006.

Selling, General and Administrative Expenses

. As a Federal government contractor we are required to categorize selling, general and administrative expenses as allowable or unallowable. Unallowable expenses are defined in the Federal Acquisition Regulations (FAR) and include lobbying expense, stock based compensation, certain investor relations expenses, legal and professional expenses for defense of lawsuits and intellectual property issues, company car expense, advertising, and travel expense over the government per-diem rates. Unallowable expenses are not reimbursable by the Federal Government. Allowable and unallowable selling general and administrative expenses for the fiscal years ending May 31, 2006 and May 31, 2005 are detailed and discussed below.

TABLE 1

Detail increase/(decrease) by account for the fiscal years	May 31, 2006	May 31, 2005	Increase / (Decrease)
Unallowable			
Selling, general & administrative expenses			
Stock based compensation	$4,769	$109,964	
Director and officer insurance	--	99,044	$(105,195)
Investor relations	14,790	52,822	(99,044)
Legal and professional	208,872	222,172	(38,032)
Lobbying	170,927	163,857	(13,300)
All other	156,374	151,194	7,070
Total	$**555,732**	$**799,053**	5,180
			$(**243,321**)
Allowable			
Selling, general & administrative expenses			
Salaries and wages	$ 407,084	$ 219,103	
Employee benefits	479,246	341,135	$ 187,981
Business development	227,733	140,412	138,111
Directors fees	170,267	106,920	87,321
Consulting fees	214,633	21,156	63,347
Insurance expense	148,073	3,711	193,477
All other	389,977	370,381	144,362
Total	**$ 2,037,013**	**$ 1,202,818**	19,596
			$ 834,195
Total selling, general and administrative expenses	**$ 2,592,745**	**$ 2,001,871**	**$ 590,874**

Salaries and wages: The increase in salary and wages is primarily due to the addition of C. Robert Knight to the administrative staff as Secretary and General Counsel. For the fiscal year ended May 31, 2006, the total wages and salaries was $157,700, compared to $0 for this position in the fiscal year ended May 31, 2005. In addition, the Company had increased secretarial support staff.

Employee benefits: The increased benefits are associated with the addition to staff of C. Robert Knight, the increase in the cost of health insurance and the issuance of an employee bonus in January 2006.

Business development: The increase in business development included trips to Germany to discuss our SOCRATES® technology and WVAS technology with Frankfort Airport Authority and to France for discussions with Airbus. We also incurred expenses in preparation for the Farnborough International Air Show in England starting July 17, 2006. We also incurred cost for trips to talk with government and industry representatives to discuss opportunities for funding the development of our TIICM™ technology.

Director's fees: There have been several unscheduled meetings of our board of directors and committee meetings concerning management succession planning, staffing and employee issues and there have been additional compliance, disclosure and ethics oversight committee meetings.

Consulting fees: We retained a consulting firm to provide market analysis and strategic planning for our UNICORN™ technology. The total cost for this consulting firm was $161,698 for fiscal year ending May 31, 2006. The balance of the increase was the result of additional costs of contract labor to support accounting and administration.

Insurance: For all of FY2005, our interpretation of the Federal Acquisition Regulations considered our Directors and Officers (D&O) insurance an unallowable expense. During a Defense Contract Audit Agency audit in September, 2005, we received a favorable opinion as to the allowability of D&O insurance. All D&O insurance is allowable for FY 2006. In addition, all insurance premiums have increased for FY 2006.

The operating losses for fiscal years ended May 31, 2006 and May 31, 2005 are primarily due to five unreimbursable non-contract costs: 1) Unallowable expenses, 2) contract cost overruns, 3) expenses during unfunded periods, 4) unabsorbed operating expenses, and/or, 5) corporate research and development primarily for TIICM™. These non-contract costs are not reimbursable under our U.S. government contracts and must be paid from other sources, primarily proceeds from the public and private sales of our equity securities. Non-contract costs have been the primary use of this source of liquidity and have had a

significant impact on our operating loss to date. Our non-contract costs are detailed below:

TABLE 2

	For the Fiscal Years Ended	
	5-31-06	5-31-05
1. Unallowable, selling, general and administrative expenses (1) (2)	$555,732	$799,053
2. Contract cost overruns	126,052	--
3. Expenses during unfunded period	--	401,903
4. Unabsorbed operating expenses	1,033,498	554,666
5. Corporate Research and Development	626,440	58,851

Total	$2,341,722	$1,814,473

Notes:

(1) Includes $4,769 of stock based compensation expense for the fiscal year ended 5-31-06.
(2) Includes $109,964 of stock based compensation expense for the fiscal year ended 5-31-05.

Below is a discussion and analysis of the non-contract cost categories listed above.

(1) Unallowable, Selling, General and Administrative Expenses. The primary reasons for the decrease in unallowable expenses for the fiscal year ending May 31, 2006 compared to that ending May 31, 2005 were decreased stock based compensation of $105,195, decreased unallowable D&O insurance of $99,044 and decreased unallowable investor relations of $38,032.

(2) Contract Cost Overruns. Contract cost overrun for the fiscal year ended May 31, 2006 represents direct labor, overhead and consulting expense, in excess of the contract funding to complete Task Order No T0001 of our current government contract.

(3) Expenses During Unfunded Period. For the year ended May 31, 2005, there was a three month period, September through November 2004 during which most of our contract work was unfunded. We had contract funding during all of our fiscal year ended May 31, 2006.

(4) Unabsorbed Operating Expenses. Unabsorbed operating expenses are primarily allowable selling, general and administrative expenses plus other recoverable operating expenses, such as depreciation, state income taxes and UNICORN™ technology research and development less the absorbed expense which we bill to the government pursuant to the terms of our government contracts. The table below details the increase of $478,832 from FY 2005 to FY 2006.

	May 31, 2006	May 31, 2005	Increase / (Decrease)
Allowable selling, general and administrative expenses		$ 1,202,818	
Other recoverable operating expenses	$ 2,037,013		$ 834,195
		$ 414,793	
Absorption / billings to government	$ 434,429		$ 19,636
		$(1,062,945)	
Increase in unabsorbed operating expenses	$(1,437,944)		$ (374,999)
		$ 554,666	
	$ 1,033,498		$ 478,832

(5) Corporate Research and Development. The increase of $567,589 for fiscal year ending May 31, 2006 compared to 2005 was due primarily to the development of our TIICM™ technology. This category represents primarily R&D for TIICM™ with minor amounts for other areas of interest.

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Liquidity and Capital Resources

Our liquidity is primarily provided by revenue from our government contracts and proceeds from the sale of our equity securities.

Our fourth contract, titled Phase IV SOCRATES®, is the fourth successive contract that we have received to continue work on our SOCRATES® wake vortex sensor and was initially funded at $1,695,029 and a second task order has provided additional funding of $1,409,025. Our funded contract backlog for our Phase IV contract as of May 31, 2006 was $1,211,484 and this backlog will fund our allowable operating expenses to approximately December 31, 2006.

As of May 31, 2006 and May 31, 2005, our cash and investments were $6,145,398 and $7,888,831, respectively. The decrease in cash on hand and investments of approximately $1,743,000 was primarily attributable to the net loss of approximately $2,258,000 and purchases of equipment and patent costs of approximately $131,000, offset by the decrease in accounts receivables/other receivables of approximately $519,000, and depreciation and amortization expense of approximately $108,000 for the fiscal year ended May 31, 2006.

As of May 31, 2006, we had other receivables of $96,673 compared to $330,010 as of May 31, 2005. The decrease is due to the billing and cash receipt of approximately $291,000 of previously unbilled receivable rate difference on our Phase III contract and the addition of approximately $58,000 for retained fees on our Phase III and IV contracts for the fiscal year ended May 31, 2006.

As of May 31, 2006, our accounts receivable were $130,001 compared to $415,617 as of May 31, 2005. The balance as of May 31, 2006 reflects the decrease in contract revenue of approximately $286,000 for the month ended May 31, 2006 compared to the month ended May 31, 2005. The decrease in revenue was due primarily to a decrease in subcontract costs for the month ending May 31, 2006. As of May 31, 2006 other current assets were $264,750 compared to $51,721 as of May 31, 2005. This increase of $213,029 is due to reimbursable legal fees we incurred of $215,488 which primarily were for the preparation of a motion to dismiss a class action suit brought against us on July 14, 2004. Our current director's and officer's insurance policy has a $200,000 deductible and the $215,488 of reimbursable legal fees is the excess of the deductible for which we expect to receive insurance proceeds.

We had total current liabilities, including accounts payable, of $831,965 as of May 31, 2006 compared to $769,653 as of May 31, 2005. Accounts payable as of May 31, 2006 were $603,538, which included $80,164 to our subcontractor, Lockheed Martin Corporation, $202,716 to four law firms, $101,235 to consultants for our UNICORN™ market study, and $219,423 in other expenses compared to accounts payable as of May 31, 2005 of $589,313, which included $319,391 to Lockheed Martin, $64,544 in legal fees and $205,378 in other expenses.

We anticipate that our funded contract balance for Task Orders 0001 and 0002 of our Phase IV contract of approximately $1,200,000 as of May 31, 2006 will fund our contract costs for SOCRATES® research and development until approximately December 31, 2006. During this period, we anticipate that we will fund a substantial portion of our other operating costs from our own cash and investments on hand.

For the three month period from June 1, 2006 to August 31, 2006, we have estimated and expect to incur approximately $225,000 in non-contract unallowable and unabsorbed operating expenses, $200,000 in contract cost overruns and approximately $250,000 in corporate research and development for project TIICM™. During this period, we have estimated and expect to receive approximately $25,000 in fees from our contract billing, and approximately $70,000 of interest income. Assuming we achieve these estimates, as to which we can make no guaranty or assurance, we estimate our available cash and investments is approximately $5,600,000 as of August 31, 2006. Any acceleration or delays in the performance of these contracts by us or our subcontractors could, respectively, exhaust or extend our contract funding prior to or after December 31, 2006. In either event, we might be required to draw upon our cash before we anticipate which would reduce the foregoing estimate of cash and investments. However, we believe that we will be able to adjust our operations to cover expenses at least through May 31, 2007.

Our use of cash projections does 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 WVAS, of which there is $0 in the current federal budget for its fiscal year ending September 30, 2006. We are actively pursuing various sources of funding but there can be no assurance as to whether or when we will obtain such funding. By September 30, 2006, there is a high probability that there will be no government or outside source of funding for the development of our SOCRATES®, UNICORN™, or TIICM™ technology and we can make no assurance as to whether or when we will obtain any such funding. Lack of and further delays in obtaining additional government contract or other outside funding will require us to draw upon our cash to fund our operations. Without such internal funding, we would be unable to carry on and complete further research and development of SOCRATES® technology or WVAS, as well as our other technologies. However, our own resources are limited and not sufficient to complete the research, development and testing that is necessary to commercialize any of our technologies. Our inability to obtain further government funding for research, development and testing of our technologies would have a material adverse affect upon our financial condition and prospects for success and profitability.

From time to time, we may consider and execute strategic investments, acquisitions, or other transactions that we believe could benefit us and could require the use of some or all of our liquidity. To facilitate such transactions and enhance our liquidity position for these and other purposes, such as working capital for research and development, we also may conduct from time to time various types of equity offerings, including, but not limited to, public or private offerings of common or preferred stock based on a negotiated fixed share value, or floating market price of our publicly traded shares. If we encounter delays in, or are unable to procure contract funding from the U.S. Government

for further research, development and testing of our SOCRATES® wake vortex sensor, incur costs over our budget, or make strategic investments, our cash resources will be reduced more rapidly than we presently anticipate. In such event, we may need to obtain additional capital to maintain operations. There can be no guarantee or assurance of our future ability to obtain capital for any of the foregoing purposes and, if obtained, the terms and conditions of such capital may dilute our present shareholders' ownership.

Known Trends, Risks and Uncertainties

Our business and future success are subject to many risks. The following describes some of the general and specific trends, risks, and uncertainties to which our business is subject and should be read with care.

Risks Related to Our Business

Our limited operating history and lack of commercial operations make it difficult to evaluate our prospects.

Since we began operations in 1997, we have generated limited revenues solely from four SOCRATES® technology research and development contracts with agencies of the federal government that fund, administer, and oversee these contracts. The federal government has funded these contracts from earmarked U.S. Congressional appropriations to agencies that have awarded these contracts to us on a sole source basis without competitive bidding. Under these contracts, we are reimbursed for certain allowable research and development costs and are paid a fee calculated as a percentage of costs.

All of our contract funding to date, including the current and next anticipated task order, has resulted from earmarks made by the U.S. Congress during its budget and appropriation process. We do not expect to receive further contract funding for fiscal year 2006 in this manner. Rather, we expect our future contract funding, if any, will depend primarily upon and result from the decision of our sponsoring agencies, particularly the FAA, to approve contract funding for research and development of our SOCRATES® wake vortex sensor or the wake vortex advisory system as part of their agency budget and make funds available for such purpose from amounts appropriated to them by Congress or other sources. There can be no assurance that we will be successful in obtaining any such funding.

We have not as yet received any revenue from the sale of any products. We do not anticipate receiving any such revenue unless and until our SOCRATES®, UNICORN™ or TIICM™ based products become operational, which could take several years. Our estimates of the market size for the products we are developing are based on many assumptions and uncertainties. Estimates for UNICORN™ have recently been evaluated by an outside consulting firm. The actual markets and price we can charge for our products, if and when we successfully complete their development, could be substantially less and our costs could be greater than our estimates. It therefore is difficult to assess our prospects for commercial sales, revenues and profitability.

We have incurred and, for the next several years, can be expected to incur operating losses.

To date, we have incurred significant net losses, including net losses of $2,257,559 for the fiscal year ended May 31, 2006, $1,411,644 for the fiscal year ended May 31, 2005 and $424,214 for the fiscal year ended May 31, 2004. We

had an accumulated deficit of $6,553,440 as of May 31, 2006. We anticipate we may continue to incur operating losses for at least the next several years. We may never generate material revenues or achieve or maintain profitability. Substantially all our revenues have been devoted to payment of costs incurred in the research, development, and testing of our SOCRATES® or UNICORN™ technology. Our ability to achieve, maintain, and/or increase profitability will depend in large part upon the successful further development and testing of our SOCRATES®, UNICORN™-based, and TIICM™ products, Congressional appropriations and our ability to obtain additional federal research and development contracts for SOCRATES®, UNICORN™ and TIICM™ based products, approval of our SOCRATES®, UNICORN™-based, and TIICM™ products and systems by various agencies of the federal government, procurement of our products and systems by the FAA, airports and the aviation industry, and the availability of funding to finance such procurements.

Lack of future funding from the federal government to complete research and development of our SOCRATES® wake vortex sensor could adversely affect our business.

The current federal budget for its fiscal year ending September 30, 2006 does not contain contract funding for further research and development of our SOCRATES® technology and, at present, it is too early to determine if we will succeed in obtaining such funding in the federal budget for its fiscal year 2007 that commences October 1, 2006. In any event, we do not anticipate the receipt of additional government funding for our Phase IV SOCRATES® technology contract, if at all, before December 31, 2006. We continue to explore government funding for research and development of our SOCRATES® technology and our other technologies, as well as other sources but can make no assurance as to whether, when or in what amount we will be able to obtain any such funding. While we believe the federal government will continue to have a long-term interest in the development of a wake vortex advisory system

and our SOCRATES® wake vortex sensor for inclusion in such a system, the U.S. government may terminate our government contract at any time if it determines such termination is in the best interests of the government or may terminate, reduce or modify it because of budgetary constraints or any change in the government's requirements. Furthermore, the federal government has in the past delayed or reduced and may in the future delay, reduce, or eliminate funding for research and development of our SOCRATES® wake vortex sensor or the wake vortex advisory system as a result of, among other things, lack of progress or set backs in technology development, a reduction in support or opposition from supervising agencies or the U.S. Congress, changes in budgetary priorities, fiscal constraints caused by federal budget deficits, or decisions to fund competing systems or components of systems. If this occurs, it will reduce our resources available for research and development of our proprietary technologies, new products or enhancements to SOCRATES®, UNICORN™ or TIICM™ technologies and to market our products. Termination or reduction of contract funding from the federal government could prevent or delay achievement of or increases in 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 research and development and our financial condition.

The government will not pay us for SOCRATES® research and development if we do not perform on our contract.

We perform our government contracts pursuant to specific work orders from the government. Such work orders include, but are not limited to, analysis of data, research, development of our SOCRATES® technology, planning and conduct of testing, and preparation of various reports. If we do not perform the contracts in accordance with their terms, the government may withhold payment on our invoices that we submit monthly. Furthermore, if at any point the government considers a test to be a failure, it may cease to approve further work orders or fund further contracts. Loss of funding on our SOCRATES® contract would have a material adverse effect on our business, financial condition, and results of operations.

Our success depends on our successful product development and testing.

Our future success will depend upon our ability to successfully complete the development, testing, and commercialization of our technologies and our ability to develop and introduce new products and services to meet industry, government, and client requirements. We are planning to eventually develop a number of products, based on our SOCRATES®, UNICORN™ and TIICM™ technologies. The process of developing such products contains significant technological and engineering hurdles and is extremely complex and expensive. In 2001, Volpe and associated federally funded research centers prepared reports which concluded it was unlikely SOCRATES® would result in a sensor that could be used for any operational procedure and even for research because of technical unknowns relating to an understanding of wake vortices and the need to obtain acceptance of WVAS by controllers and pilots. We believe this

conclusion was premature and based on an incomplete understanding of SOCRATES® and its operational potential. In our opinion, the testing and analysis we have conducted has increasingly supported this potential and resulted in the continuation of funding for our government contracts for research, development and testing of our SOCRATES® technology. However, there still are technical, engineering and program integration hurdles we must meet to develop SOCRATES® into an operational sensor, including, but not limited to, expanding the sensor to at least sixteen and as many as thirty-two laser beams, integrating the sensor into and with the other components of WVAS, and developing operating protocols for WVAS that define how it would be used by air traffic controllers and pilots. In the case of UNICORN™, we must successfully overcome development, engineering and testing hurdles to produce an operational product and obtain FAA approval of this product. Furthermore, we will need to extend the term of the experimental license the FCC has granted us and, ultimately, obtain a permanent license from the FCC for the operation of UNICORN™. We might not successfully complete the development of our SOCRATES®, UNICORN™ or TIICM™ technologies into operational products and our products may not be commercially viable. Our failure to complete development of any such products and achieve market acceptance would have a material adverse effect on our business, financial condition, and results of operations.

In addition, certain of our products will require customized installation to address unique characteristics of their environments. Customization could place an additional burden on our resources or delay the delivery or installation of products which, in turn, could have a material adverse effect on our relationship with clients, our business, financial condition, and results of operations.

Our success depends on federal government approval of our products and related systems.

The airport and aviation industry is subject to extensive government oversight and regulation. To introduce our SOCRATES®, UNICORN™ or TIICM™ based products for commercial sale, we must successfully complete research, development, and testing and obtain necessary governmental approvals for their installation. Upon approval by the Federal Aviation Administration, or FAA, our SOCRATES® wake vortex sensor would be part of a multi-component wake vortex advisory system that also will require government approvals before it can be deployed. Any factor that delays or adversely affects this approval process, including delays in development or inability to obtain necessary government approvals, could have a material adverse effect on our business, financial condition, and results of operations, and we can make no assurance when or if all such approvals will be obtained.

Our business has relied on a strategic alliance with Lockheed Martin Corporation.

In May 1997, we signed a teaming agreement with Lockheed Martin Corporation to jointly develop and market SOCRATES® based products. This agreement will expire in May 2007, unless certain earlier termination provisions occur or the agreement is extended by mutual agreement. The agreement stipulates that we serve as prime contractor and Lockheed Martin Corporation as subcontractor in the development and any deployment of our SOCRATES® wake vortex sensor. Although to date we have generally worked in close cooperation with Lockheed Martin Corporation, we do not expect that this relationship will be sustained. Future disagreements as to work scope, revenue share, profit margins, ownership of intellectual property, or technical, marketing, or management philosophy, could adversely impact the relationship. Since we view our strategic relationship with Lockheed Martin Corporation as an important element of our business plan, any erosion of this relationship could have a negative impact on our business and future value.

On April 26, 2004, in conjunction with the renewal of a nondisclosure agreement, we were advised by Lockheed Martin Corporation that it owns a certain patent which predates our SOCRATES® patent and, according to Lockheed Martin Corporation, contains some intellectual property related to our SOCRATES® patent. Lockheed Martin Corporation has told us that it was prevented from previously disclosing the patent to us because of a government secrecy order. After consultation with counsel, including our patent counsel, we strongly believe that the Lockheed Martin Corporation patent will not impair the value of our SOCRATES® patent because our SOCRATES® patent is aimed at improving air traffic safety, a use not contemplated by the Lockheed Martin Corporation patent. Furthermore, it is our position that Lockheed Martin Corporation acknowledged and accepted our invention of the SOCRATES® technology in the May 1997 teaming agreement. We have met several times with Lockheed Martin Corporation to discuss the matter and potential opportunities relating to our SOCRATES® patent. Although these

discussions are continuing, to date, Lockheed Martin Corporation continues to disagree with our position.

In our continuing discussion with Lockheed Martin Corporation concerning our respective intellectual property claims, Lockheed Martin has asserted that essentially all of its work product, which results from its research and development on SOCRATES® technology pursuant to work orders from us, is its property. We have informed Lockheed Martin that we believe that we own or have rights to use such work product, subject to any rights of the government. While we continued discussions on these and other issues, Lockheed informed us in February 2006 that it would temporarily suspend its contract effort on task order No. T0001 of our Phase IV contract for SOCRATES® technology and related matters until these issues are resolved. We continued to work on task order No. T0001 and T0002 and believe the task orders were minimally impacted by the absence of Lockheed Martin. During May 2006, Lockheed Martin agreed to language concerning SOCRATES® intellectual property that we proposed and lifted its suspension of work and started working on T0001 in June 2006. However, Lockheed Martin has declined to participate and proceed on task order T0002 as it believes that task order is beyond the scope of the teaming agreement.

In order to complete our contractual commitments to the government under T0002, we are working with Intergraph Corporation to be our principal support subcontractor for the emulation of an operational SOCRATES® wake vortex sensor within a conceptual WVAS at Denver International Airport in late 2006 or early 2007.

We can make no assurance as to whether or when these issues will be completely resolved with Lockheed Martin in a satisfactory manner. It is too early for us to assess how this situation will impact us and discussions between us and Lockheed Martin are ongoing. Any further suspension of work by Lockheed Martin could have a material adverse effect upon our ability to obtain further government funding for and carryout research, development of our SOCRATES® technology, as well as on our operations, finances and prospects for successful completion and commercialization of SOCRATES® technology. We cannot predict or provide any assurance on the outcome of these discussions and whether any outcome will be satisfactory to us.

We may need to raise additional capital.

We cannot be certain that our present financial resources will be adequate or sufficient for our future needs. We face many uncertainties with respect to research and development and the timing of commercialization of our SOCRATES®, UNICORN™ and TIICM™ based products, the availability and level of government funding, the FAA approvals required for our products, and the long sales cycle from initial customer contact to actual, if any, revenue generation. Depending on the outcome of these uncertainties, we might not be able to generate sufficient, if any, revenue or investment capital to fund our research and development and operations over the period of years we believe are required to commercialize our products. In each of our last three fiscal years, we have incurred substantial operating losses which we have funded, in part, with equity capital that we raised from new investors.

We will continue to incur significant expenses for research and development and testing of our SOCRATES®, UNICORN™ and TIICM™ technology and may continue to experience such losses prior to commercialization and thereafter. Our current financial resources are limited and are not sufficient to achieve commercialization of our SOCRATES®, UNICORN™ and TIICM™ technologies. If we are unable to generate sufficient working capital from revenue from government funding or private contracts for these purposes, we would need to seek additional capital. In addition, other unforeseen costs, including, without limitation, marketing, sales and installation and research and development costs of later generation SOCRATES®, UNICORN™ and TIICM™ based products also could require us to seek additional capital. We do not have any credit facilities in place and, should the need for additional capital arise, we may not be able to obtain sufficient, if any, additional capital or raise such capital on acceptable terms. If we need to obtain additional debt or equity capital, it may include our entry into joint ventures or issuance of additional

securities, which may cause dilution to our current capital structure and stockholders' ownership. Additional securities also could have a greater priority as to dividends, distributions and other rights than our common stock.

For the life of our public warrants, and the underwriter's warrants issued pursuant to our February 2004 public offering, and our existing unregistered options, the holders thereof are given the opportunity to profit from a rise in the market for our common stock, with a resulting dilution in the interest of all other stockholders. So long as these warrants or options are outstanding, the terms on which we could obtain additional capital may be adversely affected. The holders of these warrants or options might be expected to exercise them at a time when we would, in all likelihood, be able to obtain any needed capital by a new offering of securities on terms more favorable than those provided by these warrants or options.

Loss of key personnel could adversely affect our business.

Our future success depends to a significant degree on the skills, experience and efforts of our executive officers, Samuel A. Kovnat, Chairman of the Board and Chief Executive Officer, William B. Cotton, Vice Chairman of the Board and President, Frank L. Rees, Executive Vice President and Director, David D. Cryer, Chief Financial Officer and Treasurer, C. Robert Knight, General Counsel, Vice President of Administration and Secretary, and Dr. Neal Fine, Senior Vice President for Technology. The sustained unavailability of any one or more of those individuals for any reason could have a material adverse impact on our operations and prospects.

At a recent meeting of our Board of Directors, Mr. Kovnat and Mr. Rees announced their intention to retire on November 30, 2007. The Board intends to develop an orderly plan of succession to appropriately carry the Company forward.

We anticipate hiring additional executive officers in the future. We may not be able to complete the hiring of these additional officers in a timely manner or at all. We also depend on the ability of our executive officers and other members of senior management to continue to work effectively as a team.

Government regulation could adversely affect our business.

As a result of receiving contract funding from the federal government and our involvement in the field of aviation, our business and operations are subject to numerous government laws and regulations. In the near term, and for so long as we receive funding from the federal government, we will be subject to many procurement and accounting rules and regulations of the federal government. We are also subject to periodic audits by the Defense Contract Audit Agency, or DCAA. To date, we are current on all D.C.A.A. required audits and our last audit for FY 2006 provisional rates was completed on October 31, 2005 and accepted as submitted. Reports have been issued by the D.C.A.A. to our government customer which have stated that we are performing in accordance with Federal Acquisitions Regulations. There is no assurance that any

of the results or contents of any future audits will portray us favorably. These rules and regulations are complex in nature and sometimes difficult to interpret or apply. Adherence to these rules is reviewed by participating agencies of the federal government. If such agencies suspect or believe that violations of procurement or accounting rules and regulations have occurred, they may refer such matters to other enforcement divisions of the federal government, such as the U.S. Attorney's Office or the Inspector General's office. If we violate these rules and regulations, even if unintentionally, we may have to pay fines and penalties or could be terminated from receiving further funding from the federal government. If we market, sell and install our products in foreign countries, the laws, rules and regulations of those countries, as well as certain laws of the United States, will apply to us. Existing as well as new laws and regulations of the United States and foreign countries which regulate aviation and airports could also adversely affect our business.

Our success depends on our ability to protect our proprietary technology.

Any failure by us to protect our intellectual property could harm our business and competitive position. For example, although we have sought patent protection for our technologies, the steps we have taken or intend to take with regard to protecting our technologies may not be adequate to defend and prevent misappropriation of our technology, including the possibility of reverse engineering and the possibility that potential competitors will independently develop technologies that are substantially equivalent or superior to our technology. Furthermore, any patent we have obtained or may obtain may subsequently be invalidated for any of a variety of reasons. In addition, even if we are issued a patent, we may not be able to gain any commercial advantage from such patent. Existing United States laws afford only limited intellectual property protection.

We intend to use a combination of patent, trade secret, copyright and trademark law, nondisclosure agreements, and technical measures to protect our proprietary technology. We intend to enter into confidentiality agreements with and obtain assignments of intellectual property from all of our employees, as well as with our clients and potential clients, and intend to limit access to and distribution of our technology, documentation and other proprietary information. However, the steps we take in this regard may not be adequate to deter misappropriation or independent third-party development of our technology. In addition, the laws of some foreign countries do not protect proprietary technology rights to the same extent as do the laws of the United States. If we resort to legal proceedings to enforce our intellectual property rights, the proceedings could be burdensome and expensive and could involve a high degree of risk to our proprietary rights if we are unsuccessful in such proceedings. Moreover, our financial resources may not be adequate to enforce or defend our rights in our technology. Additionally, any patents that we apply for or obtain may not be broad enough to protect all of the technology important to our business, and our ownership of patents does not in itself prevent others from securing patents that may block us from engaging in actions necessary to our business, products, or services.

Other companies may claim that we infringe their intellectual property or proprietary rights.

If our proprietary technology violates or is alleged to violate third party proprietary rights, we may be required to reengineer our technology or seek to obtain licenses from third parties to continue offering our technology without substantial reengineering. Any such efforts may not be successful or if successful could require payments that could have a material adverse effect on our profitability and financial condition. Any litigation involving infringement claims against us would be expensive and time-consuming, and an adverse outcome may result in payment of damages or injunctive relief that could materially and adversely affect our business.

Under certain circumstances, the federal government may be able to use our SOCRATES®-related technologies or other technologies developed with government funding without payment to us.

We have taken certain steps to preserve our rights in our SOCRATES®-related technologies under our contracts with the federal government. However, as is the case with all research and development contracts funded by the federal government, the Federal Acquisition Regulations provide that, under certain circumstances, the federal government may have paid-up rights to use, or have used on its behalf, our SOCRATES®-related technologies or other technologies developed with government funding. We do not expect that the federal government will attempt to use our SOCRATES®-related technologies without compensating us. Nevertheless, if the federal government attempts to exercise these rights, it is difficult to predict what effect, if any, it may have on us. If the federal government succeeds in exercising these rights, it may have a material adverse effect on our business operations and financial performance, which could negatively affect the value of our stock.

Our future customers, including the FAA, may not accept the price of or be able to finance our products.

At present, we cannot precisely fix a price for the sale and installation of an initial SOCRATES® wake vortex sensor at airports or UNICORN™-based collision avoidance systems in small aircraft or TIICM™ in commercial airliners. We estimate that the cost of our SOCRATES® wake vortex sensor will be roughly $9 million to $20 million per airport installation, depending on, among other things, the number and configuration of runways. Due to developments in the market for general aviation collision warning and avoidance products and information we have obtained from our ongoing research, development and engineering of UNICORN™, we now expect the UNICORN™-based system could be more complex than we originally envisioned. As a result, we anticipate the wholesale price of this product could be approximately $25,000 which is substantially greater than the $10,000 price we have previously estimated. As we develop further information on the configuration and components of a UNICORN™-based

system for general aviation, related production costs, and rapidly evolving competitive technologies, we will reassess the potential market for a commercial UNICORN™-based collision avoidance system for general aviation. Our current goal is to use and build on the UNICORN™ research and development we have conducted to date for application to unmanned air vehicles, if we can obtain government funding for this purpose. While we have had discussions with the federal government in this regard, it is still too early to assess our prospects for obtaining such funding. Because we have not completed the research, development, and testing of either product or received final approvals for either of them from the federal government, we have not commenced production or marketing efforts. We currently do not anticipate having these products ready for commercial sale for at least several years. We therefore are not yet in a position to gauge the reaction of potential customers to the pricing of these products or future products and whether such potential customers will be able to afford and finance our products.

We believe that the increase in efficiency and safety to airports, airlines, and private aircraft resulting from our products will justify the substantial anticipated cost of sales and installation of these products. However, our customers' ability to afford such costs will depend, in part, on the health of the overall economy, the financial condition and budget priorities of the federal government, particularly the FAA and NASA, profitability of airports, airlines, and aircraft manufacturers, and the availability of private and government sources of funding to finance the sales and acquisition of our products. While a variety of potential funding sources exist, inability of the FAA, airlines or airports to access or obtain funding for purchase and installation of our products could have a material adverse impact on sales of our SOCRATES®, UNICORN™ or TIICM™ based products.

We may experience long sales cycles.

We expect to experience long time periods between initial sales contacts and the execution of formal contracts for our products and completion of product installations. The cycle from first contact to revenue generation in our business involves, among other things, selling the concept of our technology and products; developing and implementing a pilot program to demonstrate the capabilities and accuracy of our products; negotiating prices and other contract terms; and, finally, installing and implementing our products on a full-scale basis. We anticipate this cycle will entail a substantial period of time, on average between seven to twelve months, and the lack of revenue experienced during this cycle and the expenses involved in bringing new sales to the point of revenue generation would put a substantial strain on our resources.

Our success will depend on our ability to create effective sales, marketing, production and installation forces.

At present and for the near future, we will depend upon a relatively small number of employees and subcontractors to complete the research and development of our SOCRATES® wake vortex sensor and pursue research and development of other SOCRATES®, UNICORN™ and TIICM™ based products. The marketing and sales of these products will require us to find additional capable employees or subcontractors who can understand, explain, market, and sell our technology and products to airports, airlines, and airplane manufacturers. We also will need to assemble new personnel and/or contractors for production and installation of our products. Upon successful completion of research and development, these demands will require us to rapidly increase the number of our employees, vendors, and subcontractors. There is intense competition for capable personnel in all of these areas, and we may not be

successful in attracting, integrating, motivating, or retaining new personnel, vendors, or subcontractors for these required functions.

Our business could be adversely affected if our products fail to perform properly.

Products and systems as complex as ours may contain undetected errors or "bugs," which result in system failures, or failure to perform in accordance with industry expectations. Despite our plans for quality control and testing measures, our products including any enhancements may contain such bugs or exhibit performance degradation, particularly during the early stages of installation, and deployment. Product or system performance problems could result in loss of or delay in revenue, loss of market share, failure to achieve market acceptance, adverse publicity, injury to our reputation, diversion of development resources and claims against us by governments, airlines, airline customers, and others.

We could be subject to liability claims relating to malfunction of our technology.

Sale of our products will depend on their ability to improve airport, airline, and airplane safety and efficiency. We will take great care to test our products and systems after installation and before actual operation to insure accuracy and reliability. The FAA acquires air traffic control equipment for U.S. airports, and typically assumes the principal product liability risk for such equipment. However, unforeseen problems, misuse, or changing conditions could cause our products and systems to malfunction or exhibit other operational problems. Such problems could cause, or be perceived to cause, airplane accidents, including passenger fatalities. We may receive significant liability claims if governments, airlines, airports, passengers and other parties believe that our systems have failed to perform their intended functions. Liability claims could require us to spend significant time and money in litigation, pay substantial damages, and incur increased insurance premiums, regardless of our responsibility for such failure. Although we plan to maintain liability insurance, such coverage may not continue to be available on reasonable terms or be available in amounts sufficient to cover one or more large claims, and the insurer may disclaim coverage as to any claim.

We face significant competition from other companies.

The air safety systems and air traffic control industries are already highly competitive. Other industry participants could develop or improve their own systems to achieve the cost efficiencies and value that we believe our products will provide upon successful completion of research and development. Additional companies may enter the market with competing systems as the size and visibility of the market opportunity increases. In addition, the government could cause us to compete against other companies for research and development or production and deployment of our SOCRATES® wake vortex sensor, when and if we successfully complete its development. Many of our potential competitors have longer operating histories, greater name recognition, substantially greater financial, technical, marketing, management, service, support, and other resources than we do. Therefore, they may be able to respond more quickly than we can to new or changing opportunities, technologies, standards, or customer requirements. Competition could reduce our revenues and margins and have a material adverse effect on our operations.

New products or technologies will likely increase the competitive pressures that we face. Increased competition could result in pricing pressures, reduced margins, or the failure of our products to achieve or maintain market acceptance. The development of competing products or technologies by market participants or the emergence of new industry or government standards may adversely affect our competitive position. As a result of these and other factors, we may be

unable to compete effectively with current or future competitors. Such inability would likely have a material adverse effect on our business, financial condition, or results of operations.

Rapid technological change could render our systems obsolete.

Our business in general is characterized by rapid technological change, frequent new product and service introductions and enhancements, uncertain product life cycles, changes in customer requirements, and evolving industry standards which make us susceptible to technological obsolescence. The introduction of new products embodying new technologies, the emergence of new industry standards, or improvements to existing technologies could render our products and systems obsolete or relatively less competitive. Our future success will depend upon our ability to continue to develop and introduce a variety of new products and to address the increasingly sophisticated needs of our customers. We may experience delays in releasing new products and systems or enhancements in the future. Material delays in introducing new products and systems or enhancements may cause customers to forego purchases of our products and systems and purchase products and systems of competitors instead.

Failure to properly manage growth could adversely affect our business.

To implement our strategy, we believe that we will have to grow rapidly. Rapid growth may strain our management, financial, and other resources. To manage any future growth effectively, we must expand our sales, marketing, production, installation, and customer support organizations, invest in research and development of new products or enhancements to existing

systems that meet changing customer needs, enhance our financial and accounting systems and controls, integrate new personnel or contractors, and successfully manage expanded operations. We may not be able to effectively manage and coordinate our growth so as to achieve or maximize future profitability.

We must hire and retain skilled personnel.

Our success depends in large part upon our ability to attract, train, motivate, and retain highly skilled employees, particularly sales and marketing personnel, scientists, engineers, and other technical support personnel. Our failure to attract and retain the highly trained technical personnel that are integral to our direct sales, product development, installation, support, and professional services may limit the rate at which we can generate sales or develop new products or system enhancements, which could have a material adverse effect on our business, financial condition, or results of operations.

Any acquisition we make could disrupt our business and harm our financial condition.

We may attempt to acquire businesses or technologies that we believe are a strategic fit with our business. We currently have no commitments for any acquisition. Any future acquisition may result in unforeseen operating difficulties and expenditures, and may absorb significant management attention that would otherwise be available for ongoing development of our business. Since we may not be able to accurately predict these difficulties and expenditures, these costs may outweigh the value we realize from a future acquisition. Future acquisitions could result in issuances of equity securities that would reduce our stockholders' ownership interest, the incurrence of debt, contingent liabilities, amortization of expenses related to other intangible assets and the incurrence of large, immediate write-offs.

You should carefully read and evaluate this entire Form 10-KSB and our current SEC filings including the risks it describes and not consider or rely upon any statement, information or opinion about us that is not contained in this Form 10-KSB and our current SEC filings.

Certain statements, information and opinions about us have appeared and may continue to appear in published news reports, analysts' reports, other media sources and our web site. Some of the information contained in these reports or sources may not be material to understanding our business or may be out of date, erroneous or inconsistent with that disclosed in this Form 10-KSB and our current SEC filings. In making a decision to invest in our securities, you should not rely upon any of these statements, information or opinions and should only rely upon, consider and carefully evaluate the information and risks contained in this Form 10-KSB and our current SEC filings.

We may suffer losses from various investments that we make and related market risks.

From time to time, we may make various types of investments which include, but may not be limited to, acquisitions of other companies, strategic transactions and joint ventures, repurchase of our shares, and general investment of our available cash in various types of debt and equity securities. Some of these investments, such as acquisitions or joint ventures, may involve a high degree of risk and we could lose the entire amount of our investment. Other investments are intended to be conservative, e.g., investment of cash reserves in high quality bonds or equity funds, but are subject to judgments about many factors beyond our control which can adversely affect these types of investments. For example, a rise in such interest rates will adversely affect the value of fixed income securities we hold and we may incur a loss of principal if we have to sell under such conditions. A decline in interest rates may reduce our investment income. We attempt to be prudent in making any of the foregoing investments, which are reviewed and approved by management and our board of directors. These types of transactions are necessary and important for the success of our overall business and our efforts to create value for our shareholders. However, we have suffered losses on certain of these investments and can make no assurance that we will not suffer losses in the future. Any such losses could have a material adverse impact on our results of operations and cash available to support our operations and investment in research and development.

Risks Related to Investment in Our Securities

The price of our securities could be volatile and subject to wide fluctuations.

The market price of the securities of a pre-commercial, research and development stage aviation technology company, such as ours, can be especially volatile. Thus, the market price of our securities could be subject to wide fluctuations. In fact, the trading volume and price of our shares have fluctuated greatly. Subject to the information set forth in this Form 10-KSB, we are unaware of any specific reasons for this volatility and cannot predict whether or for how long it will continue.

If our revenues do not grow or grow more slowly than we anticipate, we are unable to procure federal contracts for our SOCRATES® wake vortex sensor UNICORN™ or TIICM™ research and development, we encounter technical or engineering obstacles to the successful commercial development of SOCRATES®, UNICORN™ or TIICM™, our operating or capital expenditures exceed our expectations and cannot be adjusted accordingly, or if some other event adversely affects us, the market price of our securities could decline. In addition, if the market for aviation technology stocks or the stock market in general experiences a loss in investor confidence or otherwise fails, the market price of our securities could fall for reasons unrelated to our business, results of operations, and financial condition. The market price of our securities also might decline in reaction to events that affect other companies in our industry even if these events do not directly affect us. Furthermore, the sale in the open market of recently sold securities or newly issued securities, which we may sell from time to time to raise funds for various purposes, and securities issuable upon the exercise of purchase rights under existing options and warrants may place downward pressure on the market price of our securities.

Speculative traders may anticipate a decline in the market price of our securities and engage in short sales of our securities. Such short sales could further negatively affect the market price of our securities.

Litigation could adversely affect our operating results and financial condition.

Companies that have experienced volatility in the market price of their stock have been the subject of securities class action litigation. We and our Chairman and Chief Executive Officer and President are defendants in pending class action litigation that alleges violations of federal securities laws and breach of fiduciary duties. A second case alleges contractual interference relating to the development of TIICM™. We firmly believe that the claims contained in both complaints are without merit and intend to conduct a vigorous defense in these matters. However, defending against existing and potential litigation will likely require significant attention and resources and, regardless of the outcome, result in significant legal expenses, which will adversely affect our results unless covered by insurance or recovered from third parties. If our defenses are ultimately unsuccessful, or if we are unable to achieve a favorable resolution, we could be liable for damage awards that could materially adversely affect our results of operations and financial condition.

An active trading market for our securities may not be developed or sustained which could limit the liquidity of an investment in our securities.

There is a limited trading market for our securities which are currently trading on the American Stock Exchange. There is no assurance that we will be able to continue to meet the listing requirements and that our securities will remain listed on the American Stock Exchange. If we are delisted from the American Stock Exchange, an investor could find it more difficult to dispose of, or to obtain accurate quotations as to the market value of, our securities. Additionally, regardless of which exchange our securities may trade on, an active and liquid trading market may not develop or, if developed, may not be sustained, which could limit security holders' ability to sell our securities at a desired price.

If any of our securities are delisted from the American Stock Exchange, we may be subject to the risks relating to penny stocks.

If any of our securities were to be delisted from trading on the American Stock Exchange and the trading price of such security remains below $5.00 per share on the date such security was delisted, trading in such security would also be subject to the requirements of certain rules promulgated under the Securities Exchange Act of 1934. These rules require additional disclosure by broker-dealers in connection with any trades involving a security defined as a penny stock and impose various sales practice requirements on broker-dealers who sell penny

stocks to persons other than established customers and accredited investors, generally institutions. The additional burdens imposed upon broker-dealers by such requirements may discourage broker-dealers from effecting transactions in our securities, which could severely limit the market price and liquidity of such securities and the ability of purchasers to sell our securities in the secondary market. A penny stock is defined generally as any non-exchange listed equity security that has a market price of less than $5.00 per share, subject to certain exceptions.

A large number of shares may be sold in the market following our February 2004 public offering which may cause the price of our securities to decline.

Sales of a substantial number of shares of our common stock or other securities in the public markets, or the perception that these sales may occur, could cause the market price of our common stock or other securities to decline and could materially impair our ability to raise capital through the sale of additional securities. We have 8,215,210 shares of our common stock outstanding. Of our outstanding shares, 6,469,972 are eligible for public trading.

Certain events could result in a dilution of your ownership of our common stock.

As of May 31, 2006, we have 8,215,210 shares of common stock and an aggregate of 3,805,300 warrants and options outstanding. The exercise price of all of our common stock equivalents ranges from $3.30 to $6.00 per share of common stock. Some of these warrants and options may provide anti-dilution protection to their holders which would result in our issuance of shares in addition to those under the warrant or option, upon the occurrence of sales of our common stock below certain prices, stock splits, redemptions, mergers, and other similar transactions. Furthermore, from time to time we may issue additional shares of common stock in private or public transactions to raise funds for working capital, research and development, acquisitions, or other purposes. If one or more of these events occurs, the number of outstanding shares of our common stock would increase and dilute your percentage ownership of our common stock.

If we do not maintain an effective registration statement or comply with applicable state securities laws, you may not be able to exercise our public warrants.

For any holder to be able to exercise our public warrants, the shares of our common stock underlying the public warrants must be covered by an effective and current registration statement and qualify or be exempt under the securities laws of the state or other jurisdiction in which you live. We cannot assure you that we will continue to maintain a current registration statement relating to the shares of our common stock underlying our public warrants or that an exemption from registration or qualification will be available throughout their term. This may have an adverse effect on demand for our public warrants and the prices that can be obtained from reselling them.

Our public warrants may be redeemed on short notice. This may have an adverse impact on their price.

We may redeem our public warrants for $0.25 per warrant, subject to adjustment in the event of a stock split, dividend or the like, upon 30 days' notice so long as the last reported sale price per share of our common stock as reported by the principal exchange or trading market on which our common stock trades equals or exceeds $10.00 (subject to adjustment) for twenty consecutive trading days ending on the tenth day prior to the date we give notice of redemption. If we give notice of redemption, holders of our public warrants will be forced to sell or exercise the public warrants they hold or accept the redemption price. The notice of redemption could come at a time when, under specific circumstances or generally, it is not advisable or possible to sell or exercise our public warrants.

Our officers, directors and 5% stockholders will exercise significant control over us.

Our current officers, directors and 5% stockholders, in the aggregate, control approximately 38.40% of our outstanding common stock (including common stock issuable to such person or group within 60 days after May 31, 2006). As a result, these stockholders acting together will be able to exert significant control over matters requiring stockholder approval, including the election of directors, approval of mergers, and other significant corporate transactions. This concentration of ownership could delay, prevent, or deter a change in control, and could deprive our stockholders of an opportunity to receive a premium for their stock as part of a sale of us and could affect the market price of our stock.

We do not intend to pay cash dividends.

We have never paid cash dividends on our stock and do not anticipate paying any cash dividends in the foreseeable future.

We may spend our funds in ways with which our stockholders may not agree.

The use of proceeds description from our recent public offering reflected our then-current planning and was only an estimate that is subject to change in our discretion. Furthermore, a substantial portion of the net proceeds from our recent public offering was not allocated for specific uses. Consequently, our management can spend our funds in ways with which our stockholders may not agree. We cannot predict that our funds will be invested or otherwise utilized to yield a favorable return.

Item 7. Financial Statements.

The audited financial statements are annexed to this report, commencing on page F-1.

Item 8. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure.

None

Item 8A. Controls and Procedures.

(a) Evaluation of disclosure controls and procedures

. Our chief executive officer and chief financial officer have reviewed and evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934 (the "Exchange Act")) as of the end of the period covered by this annual report. Based on that evaluation, the chief executive officer and chief financial officer have concluded that our current disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act are recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms.

(b) Changes in internal controls

. There have not been any significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation. There were no significant deficiencies or material weaknesses in the internal controls, and therefore no corrective actions were taken.

Item 8B. Other Information.

None

PART III

Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance With Section 16(a) of the Exchange Act.

Information about our Directors is incorporated by reference from the information under the caption "Proposal No. 2 - Election of Directors" and "Section 16 Beneficial Ownership Reporting Compliance" in our Proxy Statement for our 2006 Annual Meeting of Stockholders to be filed on or before September 22, 2006.

Item 10. Executive Compensation.

Incorporated by reference from the information under the caption "Executive and Director Compensation" in our Proxy Statement for the 2006 Annual Meeting of Stockholders to be filed on or before September 22, 2006.

Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Incorporated by reference from the information under the caption "Stock Ownership of Certain Beneficial Owners, the Board of Directors, and Executive Officers" in our Proxy Statement for the 2006 Annual Meeting of Stockholders to be filed on or before September 22, 2006.

Item 12. Certain Relationships and Related Transactions.

Incorporated by reference from the information under the captions "Certain Relationships and Related Transactions" in our Proxy Statement for the 2006 Annual Meeting of Stockholders to be filed on or before September 22, 2006.

Item 13. Exhibits.

Exhibit No.	Description
3.1	Amended and Restated Articles of Incorporation (1)
3.2	By-Laws (2)
10.1	Employment Agreement effective as of November 4, 2003, between Flight Safety Technologies, Inc.
10.2	and Samuel A. Kovnat (3)
10.3	Employment Agreement effective as of November 4, 2003, between Flight Safety Technologies, Inc.
	and William B. Cotton (4)
10.4	Employment Agreement effective as of November 4, 2003, between Flight Safety Technologies, Inc.
10.5	and David D. Cryer (5)
10.6	Employment Agreement effective as of November 4, 2003, between Flight Safety Technologies, Inc.
10.7	and Frank L. Rees (6)
10.8	Teaming Agreement dated May 1, 1997, by and between FSTO and Lockheed Martin Corporation (7)
10.9	Share Exchange Agreement between Reel Staff, Inc. and Flight Safety Technologies, Inc., dated June 24, 2002, as amended July 15, 2002 (8)
10.10	Cost Reimbursement Research Project Agreement between Flight Safety Technologies, Inc. and Georgia Tech Applied Research Corporation (9)
10.11	Phase III Contract issued by U.S. Department of Transportation/RSPA/Volpe Center, dated September 30, 2003 (10)
23	Agreement between Flight Safety Technologies, Inc. and Advanced Acoustics Concepts, Inc., dated January 14, 2000 (11)
31.1	*Employment Agreement effective as of June 23, 2005, between Flight Safety Technologies, Inc. and
31.2	C. Robert Knight
32.1	*Phase IV Contract issued by U.S. Department of Transportation/RITA/Volpe Center, dated September 1, 2005
	*Consent of Wolf & Company, P.C.
	*Chief Executive Officer Certification as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).
	*Chief Financial Officer Certification as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).
	*Certification of Chief Executive Officer and Chief Financial Officer as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).

*Submitted herewith

(1) Incorporated by reference to Exhibit 3.1 on our Form 10-QSB, which was filed on April 6,
(2) 2004.
(3) Incorporated by reference to Exhibit 3.2 on our Form SB-2, which was filed on August 9, 2001.
(4) Incorporated by reference to Exhibit 10.1 on our Form SB-2/A, which was filed on January 29,
(5) 2004.
(6) Incorporated by reference to Exhibit 10.2 on our Form SB-2/A, which was filed on January 29,
(7) 2004.
(8) Incorporated by reference to Exhibit 10.3 on our Form SB-2/A, which was filed on January 29,
(9) 2004.
(10) Incorporated by reference to Exhibit 10.4 on our Form 10-QSB, which was filed on April 6,
(11) 2004.
Incorporated by reference to Exhibit 10.7 on our 8-KA, which was filed on November 6, 2002.
Incorporated by reference to Exhibit 10.1 on our Form 8-K, which was filed on July 18, 2002.
Incorporated by reference to Exhibit 10.7 on our Form SB-2/A, which was filed on November 26, 2003.
Incorporated by reference to Exhibit 10.8 on our Form SB-2/A, which was filed on November 26, 2003.
Incorporated by reference to Exhibit 10.9 on our Form SB-2/A, which was filed on November 26, 2003.

Item 14. Principal Accountant Fees and Services.

Incorporated by reference from the information under the captions "Audit and Related Fees" in our Proxy Statement for the 2006 Annual Meeting of Stockholders to be filed on or before September 22, 2006.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Flight Safety Technologies, Inc.
a Nevada corporation

September 6, 2006 By: /s/ Samuel A. Kovnat

Samuel A. Kovnat
Chairman and Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Samuel A. Kovnat, his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this Report on Form 10-KSB, and to file the same, with Exhibits thereto and other documents in connection therewith with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or substitute or substitutes may do or cause to be done by virtue hereof.

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Date
/s/ William B. Cotton	September 6, 2006
[redacted]	
William B. Cotton, Director, President	
/s/ Frank L. Rees	September 6, 2006
[redacted]	
Frank L. Rees, Director, Executive Vice President	
/s/ David D. Cryer	September 6, 2006
[redacted]	
David D. Cryer, Chief Financial Officer, Treasurer	
/s/ C. Robert Knight	September 6, 2006
[redacted]	
C. Robert Knight, Secretary, Vice President of Administration/ General Counsel	
/s/ Kenneth S. Wood	September 6, 2006
[redacted]	
Kenneth S. Wood, Director	
/s/ Jackson Kemper	September 6, 2006
[redacted]	
Jackson Kemper, Director	
/s/ Larry L. Pressler	September 6, 2006
[redacted]	
Larry L. Pressler, Director	

/s/ Joseph J. Luca September 6, 2006

Joseph J. Luca, Director

FLIGHT SAFETY TECHNOLOGIES, INC.

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For the Years Ended May 31, 2006 and 2005

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Flight Safety Technologies, Inc.
Mystic, Connecticut

We have audited the accompanying balance sheets of Flight Safety Technologies, Inc. as of May 31, 2006 and 2005, and the related statements of operations and comprehensive income (loss), changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Flight Safety Technologies, Inc. as of May 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Wolf & Company, P.C.

Boston, Massachusetts
July 18, 2006

Balance Sheets
as of
May 31, 2006 and 2005

	2006	2005
Assets		
Current assets:		
Cash and cash equivalents	$ 145,572	$ 494,837
Contract receivables	130,001	415,617
Investments available for sale, at fair value	1,661,919	2,860,233
Investments held to maturity	4,337,907	4,033,759
Inventory	108,044	108,044
Other current assets	264,750	51,721
Total current assets	6,648,193	7,964,211
Property and equipment, net of accumulated depreciation of $418,656 and $328,608	181,606	208,562
Other Assets:		
Intangible assets, net of accumulated amortization of $65,330 and $47,377	230,750	180,562
Investments held to maturity	--	500,002
Other receivables	96,673	330,010
Total other assets	327,423	1,010,574
Total Assets	$ 7,157,222	$ 9,183,347
Liabilities and Stockholders' Equity		
Current liabilities:		

Accounts payable	$ 603,538	$ 589,313
Accrued expenses	228,427	180,340
Total current liabilities	831,965	769,653
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 at May 31, 2006 and 8,331,410 at May 31, 2005	8,332	8,331
Additional paid-in-capital	13,070,192	13,069,863
Treasury Stock, 116,300 shares at cost	(199,827)	(199,827)
Accumulated other comprehensive loss	--	(164,023)
Unearned stock compensation	--	(4,769)
Accumulated deficit	(6,553,440)	(4,295,881)
Total stockholders' equity	6,325,257	8,413,694
Total Liabilities and Stockholders' Equity	$ 7,157,222	$ 9,183,347

The accompanying notes are an integral part of these financial statements

FLIGHT SAFETY TECHNOLOGIES, INC.

Statements of Operations and Comprehensive Income (Loss)
For the Years Ended May 31, 2006 and 2005

	2006	2005

Contract Revenues	$ 3,869,962	$ 3,310,871
Cost of Revenues	2,369,311	2,233,773
Gross Profit	1,500,651	1,077,098
Operating Expenses		
Research and development	1,054,278	557,137
Selling, general and administrative	2,592,745	2,001,871
Depreciation and amortization	108,001	125,660
Total Operating Expenses	3,755,024	2,684,668
Loss From Operations	(2,254,373)	(1,607,570)
Other Income (Expense)		
Interest income	283,951	223,586
Loss on investments available for sale	(262,337)	--
Loss Before Provision For Income Taxes	(2,232,759)	(1,383,984)
Provision for income taxes	24,800	27,660
Net Loss	(2,257,559)	(1,411,644)
Other Comprehensive Income (Loss)		
Unrealized (loss) on investments	(98,314)	(44,522)
Less: reclassification adjustment for loss included in net income	262,337	--
Comprehensive Income (Loss)	$(2,093,536)	$(1,456,166)
Net Loss Per Share		

Basic and diluted	$ (.27)	$ (.17)
Weighted Average Number of Shares Outstanding		
Basic and diluted	8,215,168	8,217,971

The accompanying notes are an integral part of these financial statements

FLIGHT SAFETY TECHNOLOGIES, INC.

Statements of Changes in Stockholders' Equity
For Years Ended May 31, 2006 and 2005

Common
Stock