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KRONOS ADVANCED TECHNOLOGIES INC  
Form 10QSB  
February 14, 2008

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-QSB

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

For the quarterly period ended December 31, 2007

Or

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

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

Commission File Number: 000-30191

KRONOS ADVANCED TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Nevada  
(State or other jurisdiction of  
incorporation or organization)

87-0440410  
(I.R.S. Employer  
Identification No.)

464 Common Street, Suite 301, Belmont, MA 02478  
(Address of principal executive offices) (Zip Code)

(617) 364-5089  
(Registrant's telephone number, including area code)

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

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Yes  No

As of February 12, 2008, there were 487,626,791 shares outstanding of the issuer's common stock.

PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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The following comprise our (unaudited) consolidated financial statements for the six months ended December 31, 2007.

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### KRONOS ADVANCED TECHNOLOGIES, INC. CONSOLIDATED BALANCE SHEETS

|                            | December 31,<br>2007<br>(Unaudited) | June 30,<br>2007 |
|----------------------------|-------------------------------------|------------------|
|                            |                                     |                  |
| Assets                     |                                     |                  |
| Current Assets             |                                     |                  |
| Cash                       | \$ 211,950                          | \$ 363,955       |
| Accounts Receivable        | 46,403                              | 5,027            |
| Other Current Assets       | 12,138                              | 12,138           |
| Total Current Assets       | 270,491                             | 381,120          |
| Net Property and Equipment | 9,552                               | 6,548            |
| Other Assets               |                                     |                  |
| Intangibles                | 1,719,430                           | 1,723,150        |
| Total Other Assets         | 1,719,430                           | 1,723,150        |

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|                                                                                                                               |              |              |
|-------------------------------------------------------------------------------------------------------------------------------|--------------|--------------|
| Total Assets                                                                                                                  | \$ 1,999,473 | \$ 2,110,818 |
| -----<br>=====                                                                                                                |              |              |
| Liabilities and Stockholders' Equity (Deficit)                                                                                |              |              |
| Current Liabilities                                                                                                           |              |              |
| Accounts payable                                                                                                              | \$ 508,668   | \$ 359,019   |
| Accrued interest expenses                                                                                                     | 298,967      | 21,303       |
| Accrued expenses                                                                                                              | 75,390       | 125,000      |
| Notes payable, current portion                                                                                                | 859,000      | 859,000      |
| Notes payable to directors and officers                                                                                       | 183,941      | 225,006      |
|                                                                                                                               | -----        | -----        |
| Total Current Liabilities                                                                                                     | 1,925,966    | 1,589,328    |
| -----                                                                                                                         |              |              |
| Long Term Liabilities                                                                                                         |              |              |
| Notes payable                                                                                                                 | 4,298,559    | 3,600,000    |
| Discount for Beneficial Conversion Feature                                                                                    | (2,193,339)  | (3,365,845)  |
|                                                                                                                               | -----        | -----        |
| Total Long Term Liabilities                                                                                                   | 2,105,220    | 234,155      |
| -----                                                                                                                         |              |              |
| Total Liabilities                                                                                                             | 4,031,186    | 1,823,483    |
| -----                                                                                                                         |              |              |
| Stockholders' Equity (Deficit) Common                                                                                         |              |              |
| stock, authorized 500,000,000 shares of \$0.001 par value; Issued and outstanding - 487,626,691 and 242,342,803, respectively | 487,627      | 242,343      |
| Capital in excess of par value                                                                                                | 34,420,313   | 33,513,598   |
| Accumulated deficit                                                                                                           | (36,939,653) | (33,468,606) |
|                                                                                                                               | -----        | -----        |
| Total Stockholders' Equity (Deficit)                                                                                          | (2,031,713)  | 287,335      |
| -----                                                                                                                         |              |              |
| Total Liabilities and Stockholders' Equity (Deficit)                                                                          | \$ 1,999,473 | \$ 2,110,818 |
| -----<br>=====                                                                                                                |              |              |

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

KRONOS ADVANCED TECHNOLOGIES, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS

|       | Three months ended December 31, |             | Six months ended Dec |       |
|-------|---------------------------------|-------------|----------------------|-------|
|       | 2007                            | 2006        | 2007                 | (U    |
|       | -----                           | -----       | -----                | ----- |
|       | (Unaudited)                     | (Unaudited) | (Unaudited)          | (U    |
| Sales | \$ 294,055                      | \$ 102,282  | \$ 319,055           | \$    |

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|                                                                                                                                                       |                |              |                |       |
|-------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|--------------|----------------|-------|
| Cost of sales                                                                                                                                         | 143,672        | 82,036       | 143,672        |       |
|                                                                                                                                                       | -----          | -----        | -----          |       |
| Gross Profit                                                                                                                                          | 150,383        | 20,246       | 175,383        |       |
|                                                                                                                                                       | -----          | -----        | -----          |       |
| Selling, General and Administrative expenses                                                                                                          |                |              |                |       |
| Compensation and benefits (includes equity compensation of \$397,032 and \$114,848 for the six months ended December 31, 2007 and 2006, respectively) | 569,191        | 375,271      | 1,117,851      |       |
| Research and development                                                                                                                              | 13,000         | 5,389        | 121,794        |       |
| Professional services                                                                                                                                 | 190,211        | 82,392       | 360,162        |       |
| Depreciation and amortization                                                                                                                         | 109,940        | 118,840      | 219,335        |       |
| Insurance                                                                                                                                             | 29,144         | 29,700       | 59,534         |       |
| Facilities                                                                                                                                            | 30,160         | 25,221       | 60,321         |       |
| Other selling general and administrative expenses                                                                                                     | 159,565        | 180,568      | 216,020        |       |
|                                                                                                                                                       | -----          | -----        | -----          |       |
| Selling, General and Administrative expenses                                                                                                          | 1,101,211      | 817,381      | 2,155,017      | 1     |
|                                                                                                                                                       | -----          | -----        | -----          |       |
| Net Operating Loss                                                                                                                                    | (950,828)      | (797,135)    | (1,979,634)    | (1    |
| Accretion of note discount                                                                                                                            | (886,847)      | -            | (1,172,504)    |       |
| Interest expense                                                                                                                                      | (169,896)      | (74,722)     | (318,908)      |       |
|                                                                                                                                                       | -----          | -----        | -----          |       |
| Net Loss                                                                                                                                              | \$ (2,007,571) | \$ (871,857) | \$ (3,471,046) | \$ (1 |
|                                                                                                                                                       | =====          | =====        | =====          |       |
| Basic and Diluted Loss Per Share                                                                                                                      | \$ (0.01)      | \$ (0.00)    | \$ (0.01)      | \$    |
|                                                                                                                                                       | =====          | =====        | =====          |       |
| Weighted average shares outstanding                                                                                                                   | 243,813,291    | 183,008,781  | 243,349,768    | 166   |
|                                                                                                                                                       | =====          | =====        | =====          |       |

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

KRONOS ADVANCED TECHNOLOGIES, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS

For the six months ended December 31,

|                                      | 2007        | 2006        |
|--------------------------------------|-------------|-------------|
|                                      | -----       | -----       |
|                                      | (Unaudited) | (Unaudited) |
| CASH FLOWS FROM OPERATING ACTIVITIES |             |             |

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|                                                                  |                |                |
|------------------------------------------------------------------|----------------|----------------|
| Net loss from operations                                         | \$ (3,471,046) | \$ (1,714,429) |
| Adjustments to reconcile net loss to net cash used in operations |                |                |
| Depreciation and amortization                                    | 219,329        | 227,690        |
| Accrued interest converted to notes payable                      | -              | 130,476        |
| Options issued for compensation/services                         | 397,032        | 114,848        |
| Accretion of note discount                                       | 1,172,504      | -              |
| Change In                                                        |                |                |
| Accounts receivable                                              | (41,376)       | (45,936)       |
| Prepaid expenses and other assets                                | -              | (2,743)        |
| Deferred revenue                                                 | -              | (20,000)       |
| Accounts payable                                                 | 149,649        | 189,003        |
| Accrued expenses and other liabilities                           | 209,032        | (37,227)       |
|                                                                  | -----          | -----          |
| Net cash Used in Operations                                      | (1,364,876)    | (1,158,318)    |
| CASH FLOWS FROM INVESTING ACTIVITIES                             |                |                |
| Purchases of property and equipment                              | (5,396)        | (2,194)        |
| Investment in patent protection                                  | (213,212)      | (79,725)       |
|                                                                  | -----          | -----          |
| Net cash Used in Investing Activities                            | (218,608)      | (81,919)       |
|                                                                  | -----          | -----          |
| CASH FLOWS FROM FINANCING ACTIVITIES                             |                |                |
| Issuance of common stock                                         | 754,967        | 1,050,000      |
| Repayment of short-term borrowings                               | (22,048)       | (354,237)      |
| Proceeds from long-term borrowings                               | 1,430,000      | -              |
| Retirement and repayment of long term debt                       | (731,440)      | -              |
|                                                                  | -----          | -----          |
| Net cash Provided by Financing Activities                        | 1,431,479      | 695,763        |
|                                                                  | -----          | -----          |
| NET DECREASE IN CASH                                             | (152,005)      | (544,474)      |
| CASH                                                             |                |                |
| Beginning of period                                              | 363,955        | 598,323        |
|                                                                  | -----          | -----          |
| End of period                                                    | \$ 211,950     | \$ 53,849      |
|                                                                  | =====          | =====          |
| Supplemental disclosure of cash flow information:                |                |                |
| Interest paid in cash                                            | \$ 59,573      | \$ 194,000     |
|                                                                  | =====          | =====          |
| Debt satisfied with stock                                        | \$ 731,440     | \$ -           |
|                                                                  | =====          | =====          |

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

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Kronos Advanced Technologies, Inc. ("Kronos" or the "Company") is a Nevada corporation. The Company's shares began trading on the over-the-counter bulletin board exchange on August 28, 1996 under the symbol "TSET." Effective January 12, 2002, the Company began doing business as Kronos Advanced Technologies, Inc. and, as of January 18, 2002, it changed the Company ticker symbol to "KNOS." On December 31, 2007, AirWorks Funding LLLP ("AirWorks") and Hilltop Holding Company, LP ("Hilltop") converted \$731,440 of their Secured Convertible Promissory Notes into 243,813,400 shares of Kronos common stock resulting in a change of control of Kronos (refer to Note 9 - Commitments and Contingencies).

### NOTE 2 - BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Kronos have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all the information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments necessary to present fairly the information set forth therein have been included. Operating results for the three and six months ended December 31, 2007 are not necessarily indicative of the results that may be experienced for the fiscal year ending June 30, 2008.

These consolidated financial statements are those of the Company and its wholly-owned subsidiary. All significant inter-company accounts and transactions have been eliminated in the preparation of the consolidated financial statements.

The accompanying consolidated financial statements should be read in conjunction with the Kronos Advanced Technologies, Inc. Form 10-KSB for the fiscal year ended June 30, 2007, which was filed on September 28, 2007.

### NOTE 3 - REALIZATION OF ASSETS AND GOING CONCERN

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. The Company has sustained losses from operations in recent years, and such losses have continued through the year ended June 30, 2007. In addition, the Company has used more cash than that provided from cash in its operations. The Company is currently using its resources to commercialize its technology and develop viable commercial products, and to provide for its working capital needs.

In view of the matters described in the preceding paragraph, recoverability of a major portion of the asset amounts shown in the accompanying balance sheet is dependent upon continued operations of the Company, which in turn is dependent upon the Company's ability to meet its financing requirements on a continuing basis and to succeed in its future operations. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

Management has taken the following steps with respect to its operating and financial requirements, which it believes are sufficient to provide the Company with the ability to continue in existence:

Retailer. In October 2007, Kronos executed a Letter of Intent for the development, manufacture and sale of air purification devices based upon Kronos' proprietary air movement and purification technology with a leading national retailer. It is expected that Kronos and the retailer would enter into a definitive purchase and supply agreement providing for the exclusive sale of private label residential standalone air purifiers through the retailer's

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distribution channels. Actual purchases of the products are dependent on the successful development of the product, the negotiation of a definitive purchase and supply agreement incorporating the terms of the letter of intent, other usual and customary terms and the retailers' discretion. Under the terms of the Letter of Intent, the retailer has paid Kronos \$250,000 towards the development costs of the new products and will contribute marketing resources to assist in the product development process. The intent of the parties is for Kronos to lead and manage all development, production and manufacturing activities for the Kronos air purifier and for the retailer to actively market the Kronos air purifier through their distribution channels. In December 2007, Kronos completed design and developed of an Alpha Prototype for the customer. In January 2008, the parties initiated negotiations of a definitive Product Development and Purchase Agreement. During the six months ended December 31, 2007, Kronos received \$250,000 in product development fees.

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EOL. In December 2005, Kronos executed a non-exclusive License Agreement with EOL LLC, a Russian Federation corporation ("EOL"), based in Korolev, Moscow Region. EOL is leveraging the Kronos technology to produce, market, and distribute Kronos commercial air purification products, bacteriological and virus destruction devices in select Commonwealth of Independent States. The agreement comes after successful completion of multiple tests in Eastern Europe, which found the Kronos technology capable of decontaminating rooms infected with airborne viruses and bacteria. Under the terms of the five-year agreement, EOL is providing Kronos a fixed percentage royalty on every product sold, as well as upfront licensing and quarterly maintenance fees. The initial medical products are currently being marketed in Russia and Ukraine and marketing plans are being put in place in, Kazakhstan, Moldova and Byelorussia. During the fiscal year ended June 30, 2007, Kronos earned \$104,000 in revenue from the sale of power supplies, other electrical components and engineering services and from the royalty from the sale of finished products by EOL. During the six months ended December 31, 2007, Kronos earned \$35,000 in licensing fees.

Global Appliance Manufacturers. In October 2006, a leading global home appliance manufacturer committed to fund 20% of the cost for Kronos to manufacturer a silent kitchen range hood product. This next generation range hood device represented the culmination of more than twelve months of product design and development effort by Kronos to apply our technology to this unique embedded residential application. The product was shipped to the customer in October 2006. In January 2007, the prototype design was modified based on customer input and a revised unit was shipped to the customer. In addition to financial support, the customer has also provided Kronos with product components for Kronos testing and evaluation. In February 2007, a second global appliance manufacturer committed to purchase additional prototypes from Kronos. During the fiscal year ended June 30, 2007, Kronos earned \$37,000 in revenue from the development of prototype devices for the residential range hood market place. In October 2007, Kronos shipped the additional prototypes to the customer for testing and evaluation. During the six months ended December 31, 2007, Kronos earned \$34,000 in product development fees.

DESA. In June 2006, the Company executed its first license for embedded applications of Kronos technology with DESA LLC ("DESA"). The agreement provides DESA the opportunity to embed the Kronos electrostatic air movement technology within fireplaces, hearth systems, zone heaters and mounted electric fans and heaters. In October 2006, DESA approved Kronos' designs for the first Kronos-based product and committed to the funding of the product development by Kronos. In January 2007, DESA committed additional funds for Kronos' exploration of a second Kronos-based product application. By May 2007, various prototype configurations for each of the two product applications were under test and evaluation by Kronos and DESA. During the six months ended December 31, 2007,

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Kronos and DESA developed a plan for product commercialization, which the Company has not begun implementing pending the prioritization of resources.

Washington Technology Center. In June 2007, the Washington Technology Center awarded the Company, in conjunction with the University of Washington and Intel Corporation, continued funding for a research and development project based on a novel cooling system for microelectronics and computer chips. This Phase III award follows the Company's Phase I and Phase II awards in December 2005 and June 2006, respectively.

### NOTE 4 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Accounting Method.** The Company's consolidated financial statements are prepared using the accrual method of accounting. The Company has elected a June 30 fiscal year end.

**Principles of Consolidation.** The consolidated financial statements of the Company include those of the Company and its subsidiary for the periods in which the subsidiary was owned by the Company. All significant intercompany accounts and transactions have been eliminated in the preparation of the consolidated financial statements. At December 31, 2007, we had only one subsidiary, Kronos Air Technologies, Inc.

**Use of Estimates.** The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the periods. Actual results could differ from those estimates.

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**Concentrations of Credit Risk.** Financial instruments which can potentially subject the Company to concentrations of credit risk consist principally of trade account receivables. The Company manages its exposure to risk through ongoing credit evaluations of its customers and generally does not require collateral. The Company maintains an allowance for doubtful accounts for potential losses and does not believe it is exposed to concentrations of credit risk that are likely to have a material adverse impact on the Company's financial position or results of operations.

**Cash and Cash Equivalents.** The Company considers all highly liquid short-term investments, with a remaining maturity of three months or less when purchased, to be cash equivalents. The Company maintains cash and cash equivalents with high-credit, quality financial institutions. At December 31, 2007 the cash balances held at financial institutions were in excess of federally insured limits.

**Accounts Receivable.** The Company provides an allowance for potential losses, if necessary, on trade accounts receivables based on a review of the current status of existing receivables and management's evaluation of periodic aging of accounts. Accounts receivable are shown net of allowances for doubtful accounts of \$0 at December 31, 2007 and June 30, 2007. The Company charges off accounts receivable against the allowance for losses when an account is deemed to be uncollectable.

**Property and Equipment.** Property and equipment are recorded at cost. Depreciation is provided over the estimated useful lives of the assets, which range from three to seven years. Expenditures for major renewals and betterments that extend the original estimated economic useful lives of the applicable

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assets are capitalized. Expenditures for normal repairs and maintenance are charged to expense as incurred. The cost and related accumulated depreciation of assets sold or otherwise disposed of are removed from the accounts, and any gain or loss is included in operations.

Intangibles. The Company uses assumptions in establishing the carrying value, fair value and estimated lives of the Company's long-lived assets and goodwill. The criteria used for these evaluations include management's estimate of the asset's continuing ability to generate positive income from operations and positive cash flow in future periods compared to the carrying value of the asset, the strategic significance of any identifiable intangible asset in its business objectives, as well as the market capitalization of the Company. Cash flow projections used for recoverability and impairment analysis use the same key assumptions and are consistent with projections used for internal budgeting, and for lenders and other third parties. If assets are considered to be impaired, the impairment recognized is the amount by which the carrying value of the assets exceeds the fair value of the assets. Useful lives and related amortization or depreciation expense are based on the Company's estimate of the period that the assets will generate revenues or otherwise be used by Kronos. Factors that would influence the likelihood of a material change in the Company's reported results include significant changes in the asset's ability to generate positive cash flow, loss of legal ownership or title to the asset, a significant decline in the economic and competitive environment on which the asset depends, significant changes in the Company's strategic business objectives, and utilization of the asset. The Company capitalizes to Intangibles the legal cost and filings fees for securing patents for the Company's proprietary technology.

Income Taxes. Income taxes are accounted for in accordance with the provisions of Statement of Financial Accounting Standards ("SFAS") No. 109. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amounts expected to be realized, but no less than quarterly.

Research and Development Expenses. Costs related to research and development are charged to research and development expense as incurred.

Net Loss Per Share. Basic loss per share is computed using the weighted average number of shares outstanding. Diluted loss per share is computed using the weighted average number of shares outstanding adjusted for the incremental shares attributed to outstanding options and warrants to purchase common stock, when their effect is dilutive.

Revenue Recognition. The Company recognizes revenue in accordance with Staff Accounting Bulletin (SAB) 104, which requires evidence of an agreement, delivery of the product or services at a fixed or determinable price, and assurance of collection within a reasonable period of time. Further, Kronos Air Technologies recognizes revenue on the sale of the custom-designed contract sales under the percentage-of-completion method of accounting in the ratio that costs incurred to date bear to estimated total costs. For uncompleted contracts where costs and estimated profits exceed billings, the net amount is included as an asset in the balance sheet. For uncompleted contracts where billings exceed costs and

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estimated profits, the net amount is included as a liability in the balance sheet. Sales are reported net of applicable cash discounts and allowances for returns. Revenue from government grants for research and development purposes is recognized as revenue as long as the Company determines that the government will not be the sole or principal expected ultimate customer for the research and development activity or the products resulting from the research and development activity. Otherwise, such revenue is recorded as an offset to research and development expenses in accordance with the Audit and Accounting Guide, Audits of Federal Government Contractors. In either case, the revenue or expense offset is not recognized until the grant funding is invoiced and any customer acceptance provisions are met or lapse.

Stock, Options and Warrants Issued for Services. Issuances of shares of the Company's stock to employees or third-parties for compensation or services is valued using the closing market price on the date of grant for employees and the date services are completed for non-employees. Issuances of options and warrants of the Companies stock are valued using the Black-Scholes option model.

Stock Options. In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 123R, Share-Based Payment ("SFAS No. 123R"). This Statement is a revision of SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. SFAS No. 123R focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS No. 123R requires entities to recognize stock compensation expense for awards of equity instruments to employees based on the grant-date fair value of those awards (with limited exceptions). Kronos elected to implement the provisions of SFAS No. 123R in the fiscal year ended June 30, 2005.

### Recent Accounting Pronouncements

In September 2006, the FASB issued FASB Statement No. 157 "Fair Value Measurements". This Statement defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles ("GAAP"), and expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is a relevant measurement attribute. Accordingly, this statement does not require any new fair value measurements. However, for some entities, the application of this statement will change current practices. This statement is effective for financial statements for fiscal years beginning after November 15, 2007. Earlier application is permitted provided that the reporting entity has not yet issued financial statements for that fiscal year. Management believes this statement will have no impact on the financial statements of the Company once adopted.

In February 2007, the FASB issued FASB Statement No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities--Including an amendment of FASB Statement No. 115". This statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This statement is expected to expand the use of fair value measurement, which is consistent with the FASB's long-term measurement objectives for accounting for financial instruments. This statement applies to all entities, including not-for-profit organizations. Most of the provisions of this statement apply only to entities that elect the fair value option. However, the amendment to FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, applies to all entities with available-for-sale and

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trading securities. Some requirements apply differently to entities that do not report net income. Management is currently evaluating the impact, if any, this statement will have impact on the financial statements of the Company once adopted.

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In December 2007, the FASB issued FASB Statement No. 141 (revised 2007), "Business Combinations." This statement replaces FASB Statement No. 141, Business Combinations. This statement retains the fundamental requirements in Statement 141 that the acquisition method of accounting (which Statement 141 called the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. This statement defines the acquirer as the entity that obtains control of one or more businesses in the business combination and establishes the acquisition date as the date that the acquirer achieves control. This statement's scope is broader than that of Statement 141, which applied only to business combinations in which control was obtained by transferring consideration. By applying the same method of accounting--the acquisition method--to all transactions and other events in which one entity obtains control over one or more other businesses, this statement improves the comparability of the information about business combinations provided in financial reports. This statement requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions specified in the statement. This replaces Statement 141's cost-allocation process, which required the cost of an acquisition to be allocated to the individual assets acquired and liabilities assumed based on their estimated fair values. This statement applies to all transactions or other events in which an entity (the acquirer) obtains control of one or more businesses (the acquiree), including those sometimes referred to as "true mergers" or "mergers of equals" and combinations achieved without the transfer of consideration, for example, by contract alone or through the lapse of minority veto rights. This statement applies to all business entities, including mutual entities that previously used the pooling-of-interests method of accounting for some business combinations. It does not apply to: (a) the formation of a joint venture, (b) the acquisition of an asset or a group of assets that does not constitute a business, (c) a combination between entities or businesses under common control, or (d) a combination between not-for-profit organizations or the acquisition of a for-profit business by a not-for-profit organization. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. An entity may not apply it before that date. Management believes this statement will have no impact on the financial statements of the Company once adopted.

In December 2007, the FASB issued FASB Statement No. 160 - "Noncontrolling Interests in Consolidated Financial Statements" - an amendment of ARB No. 51. This statement applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, but will affect only those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. Not-for-profit organizations should continue to apply the guidance in Accounting Research Bulletin No. 51, Consolidated Financial Statements, before the amendments made by this statement, and any other applicable standards, until the Board issues interpretative guidance. This statement amends ARB 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. Before this statement was issued, limited guidance existed for reporting noncontrolling

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interests. As a result, considerable diversity in practice existed. So-called minority interests were reported in the consolidated statement of financial position as liabilities or in the mezzanine section between liabilities and equity. This statement improves comparability by eliminating that diversity. A noncontrolling interest, sometimes called a minority interest, is the portion of equity in a subsidiary not attributable, directly or indirectly, to a parent. The objective of this statement is to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards that require: (a) the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated statement of financial position within equity, but separate from the parent's equity, (b) the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income, (c) changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently. A parent's ownership interest in a subsidiary changes if the parent purchases additional ownership

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interests in its subsidiary or if the parent sells some of its ownership interests in its subsidiary. It also changes if the subsidiary reacquires some of its ownership interests or the subsidiary issues additional ownership interests. All of those transactions are economically similar, and this statement requires that they be accounted for similarly, as equity transactions, (d) when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary be initially measured at fair value. The gain or loss on the deconsolidation of the subsidiary is measured using the fair value of any noncontrolling equity investment rather than the carrying amount of that retained investment, and (e) entities provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. This statement shall be applied prospectively as of the beginning of the fiscal year in which this statement is initially applied, except for the presentation and disclosure requirements. The presentation and disclosure requirements shall be applied retrospectively for all periods presented. Management believes this statement will have no impact on the financial statements of the Company once adopted. Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the financial statements upon adoption.

### NOTE 5 -- INCOME TAXES

The composition of deferred tax assets and the related tax effects at December 31, 2007 and June 30, 2007 are as follows:

|                                                               | December 31, 2007<br>(unaudited) | June 30, 2007  |
|---------------------------------------------------------------|----------------------------------|----------------|
|                                                               | -----                            | -----          |
| Benefit from carryforward of capital and net operating losses | \$ (9,284,000)                   | \$ (7,698,000) |
| Other temporary differences                                   | (157,000)                        | (157,000)      |
| Options issued for services                                   | (143,000)                        | (551,000)      |
| Less:                                                         |                                  |                |

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|                        |           |           |
|------------------------|-----------|-----------|
| Valuation allowance    | 9,584,000 | 8,406,000 |
|                        | -----     | -----     |
| Net deferred tax asset | \$ -      | \$ -      |
|                        | =====     | =====     |

The other temporary differences shown above relate primarily to impairment reserves for intangible assets, and accrued and deferred compensation. The difference between the income tax benefit in the accompanying statements of operations and the amount that would result if the U.S. Federal statutory rate of 34% were applied to pre-tax loss is as follows:

|                                 | December 31, 2007<br>(Unaudited) |                      | June 30, 2007 |
|---------------------------------|----------------------------------|----------------------|---------------|
|                                 | Amount                           | % of<br>Pre-Tax Loss | Amount        |
| Benefit for income tax at:      |                                  |                      |               |
| Federal statutory rate          | \$ (683,000)                     | (34.0)%              | \$ (799,000)  |
| State statutory rate            | (40,000)                         | (2.0)%               | (47,000)      |
| Non-deductible expenses         | 48,000                           | 2.4 %                | 24,000        |
| Increase in valuation allowance | 675,000                          | 33.6 %               | 822,000       |
|                                 | \$ -                             | 0.0 %                | \$ -          |
|                                 | =====                            | =====                | =====         |

The non-deductible expenses shown above related primarily to the amortization of intangible assets and to the accrual of stock options for compensation using different valuation methods for financial and tax reporting purposes.

At December 31, 2007, the Company has approximately \$21.4 million of unused Federal net operating losses, \$2.3 million of capital losses and \$17.2 million of state net operating losses available for carryforward to future years. As a result of the conversion of certain of the Secured Convertible Promissory Notes in December 2007, the Company has had a "change of ownership" as defined under section 382 of the Internal Revenue Code. Due to this change of ownership, the Company's net operating losses, as of the date of change, are subject to an annual limitation. This limitation is equal to the value of the Company's stock at the date of change, multiplied by an interest factor (approximately 4.5%). Any losses incurred after the date of change are not subject to limitation.

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### NOTE 6 - SEGMENTS OF BUSINESS

The Company has only one reportable segment, which consists of developing, licensing, manufacturing and distributing air movement and purification devices utilizing the Kronos technology. For the six months ended December 31, 2007 and the fiscal year ended June 30, 2007 the Company operated only in the U.S.

### NOTE 7 - EARNINGS PER SHARE

Weighted average shares outstanding used in the earnings per share calculation were 243,813,291 and 166,082,956 for the six months ended December 31, 2007 and 2006, respectively.

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As of December 31, 2007, there were outstanding options to purchase 90,259,775 shares of the Company's common stock and outstanding warrants to purchase 15,792,342 shares of the Company's common stock. These options and warrants have been excluded from the earnings per share calculation as their effect is anti-dilutive. As of December 31, 2006, there were outstanding options to purchase 24,144,928 shares of the Company's common stock and outstanding warrants to purchase 42,300,000 shares of the Company's common stock. These options and warrants have been excluded from the earnings per share calculation as their effect is anti-dilutive.

### NOTE 8 - CONVERTIBLE NOTES PAYABLE AND NOTES PAYABLE

The Company had the following obligations as of as of December 31, 2007 and June 30, 2007:

|                                                     | December 31, 2007<br>(Unaudited) | June 30, 2007 |
|-----------------------------------------------------|----------------------------------|---------------|
|                                                     | -----                            | -----         |
| Obligations to AirWorks Funding LLLP (1)            | \$ 3,051,135                     | \$ 2,480,000  |
| Obligations to Hilltop Holding Company, LP (1)      | 1,047,424                        | 920,000       |
| Discount for beneficial conversion feature (2)      | (2,193,339)                      | (3,365,845)   |
| Obligations to Sands Brothers (3)                   | 859,000                          | 859,000       |
| Obligations to Gumbinner and Sun (4)                | 200,000                          | 200,000       |
| Obligation to current employees (5)                 | 183,941                          | 202,307       |
|                                                     | -----                            | -----         |
|                                                     | 3,148,161                        | 1,295,462     |
| Less: Current portion                               | 1,042,941                        | 1,061,307     |
|                                                     | -----                            | -----         |
| Total long term obligations, net of current portion | \$ 2,105,220                     | \$ 234,155    |
|                                                     | =====                            | =====         |

- (1) These notes bear interest at the rate of 12%, are secured by the assets of the Company and are convertible into shares of Kronos common stock at \$0.003 or are payable in full on June 19, 2010.
- (2) Under GAAP, the Company recorded a discount for the beneficial conversion feature ("BCF") on the initial amount of the convertible debt issued to AirWorks and Hilltop. Kronos did not recognize a BCF discount for any additional amounts of the notes to AirWorks and Hilltop because the AirWorks and Hilltop conversion feature was capped. The amount of BCF discount was calculated using the Black-Scholes model. Because the maximum value of the BCF discount can not exceed the full value of the issued debt, the Company recorded the discount at the full value of the initial debt of \$3,400,000. The Company is amortizing the BCF discount over the three year life of the debt. For the six months ended December 31, 2007, the Company recorded a BCF discount amortization of \$1,172,504.
- (3) These notes bear interest at the rate of 12%, are secured by the assets of the Company and are payable in full on February 28, 2008.
- (4) These notes bear interest at the rate of 12%, are secured by the assets of the Company and are convertible into shares of Kronos common stock at \$0.003 or are payable in full on June 19, 2010. Kronos has not recognized a BCF discount on these notes because they are not convertible into Kronos common stock until the occurrence of future events outside the control of the note holders.
- (5) These notes bear interest at the rate of 12%. They represent obligations to current employees of the Company, which are currently due in full.

### NOTE 9 - COMMITMENTS AND CONTINGENCIES

In June 2007, Kronos entered into a Funding Agreement with a group of lenders providing for a loan, at the discretion of the lenders, in the aggregate amount

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of up to \$18,159,000. At the initial closing, the Company received an initial advance of \$4,259,000. After payment in full of the amounts due under a convertible debenture issued to Cornell Capital Partners and the settlement agreement obligation to HoMedics and payment of the expenses of the transaction, the remainder of \$1,069,000 was used for working capital purposes. The initial new lenders were: (i) AirWorks Funding LLLP, a newly-formed limited partnership; (ii) Critical Capital Growth Fund, L.P. and various Sands Brothers Venture Funds, all of which are affiliates of Laidlaw and Co. (UK) Ltd. and (iii) RS Properties I LLC, a New York-based private investment company. RS Properties assigned to Hilltop Holding Company, LP, a Delaware limited partnership, ("Hilltop") its promissory note together with certain other rights and agreements relating thereto, including, without limitation, its rights and obligations under the Funding Agreement. During the six months ended December 31, 2007, the Company received an additional \$1,430,000 in funding under the terms of the Funding Agreement and related notes.

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The loan is secured by all of the Company's assets and is convertible into shares of the Company's common stock at a conversion price of \$0.003 per share, subject to adjustment under certain circumstances. Future installments under the Funding Agreement, up to \$12,470,000, may be advanced at the discretion of the lenders, even if not requested by the Company. Under the Funding Agreement and related notes, the Company pays interest on the notes at the rate of 12% per annum. Of the total amount of the initial advance, monthly interest payments commence on July 1, 2007 on \$859,000, which was initially due and payable on December 31, 2007. In December 2007, Critical Capital and Sands Brothers agreed to extend the maturity date of their note until February 28, 2008. The outstanding amounts under this note may be converted into Kronos common stock at the option of the holder at the \$0.003 conversion price only if not paid in full by February 28, 2008. With respect to all other loan amounts, interest is paid quarterly starting January 1, 2008 and outstanding principal is due and payable June 19, 2010, unless earlier converted at the option of the lenders. Assuming the payment when due of the \$859,000, the maximum loan amount is advanced under the Funding Agreement and related notes and the lenders convert the entire amount of the loan into Kronos common stock at the noted conversion price, the lenders would own approximately 93.3% of the Company's total equity on a fully diluted, as converted basis. In December 2007, AirWorks and Hilltop converted \$731,440 of their Secured Convertible Promissory Notes into 243,813,400 shares of Kronos common stock resulting in a change of control of Kronos.

Daniel R. Dwight, President and Chief Executive Officer, and the Company entered into an employment agreement effective as of November 15, 2001. The initial term of Mr. Dwight's employment agreement was for two years and will automatically renew for successive one year terms unless Kronos or Mr. Dwight provide the other party with written notice within three months of the end of the initial term or any subsequent renewal term. Mr. Dwight's employment agreement was last renewed on August 15, 2007. In April 2006, the Board of Directors increased Mr. Dwight's base cash compensation to \$225,000 per year effective April 15, 2006. Mr. Dwight is eligible for annual incentive bonus compensation in an amount equal to Mr. Dwight's annual salary based on the achievement of certain bonus objectives. In addition, Kronos granted Mr. Dwight 1,000,000 immediately vested and exercisable, ten-year stock options at various exercise prices. Mr. Dwight is entitled to fully participate in any and all 401(k), stock option, stock bonus, savings, profit-sharing, insurance, and other similar plans and benefits of employment.

Richard F. Tusing, Chief Operating Officer, and the Company entered into an employment agreement effective as of January 1, 2003. The initial term of Mr. Tusing's employment agreement was for two years and will automatically renew for successive one year terms unless Kronos or Mr. Tusing provide the other party

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with written notice within three months of the end of the initial term or any subsequent renewal term. Mr. Tusing's employment agreement was last renewed on November 1, 2007. Mr. Tusing's employment agreement provides for base cash compensation of \$160,000 per year. Mr. Tusing will be entitled to fully participate in any and all 401(k), stock option, stock bonus, savings, profit-sharing, insurance, and other similar plans and benefits of employment.

In October 2006, Thompson E. Fehr filed a complaint in the Second Judicial District Court of Weber County in the state of Utah against Kronos with respect to prior services rendered to High Voltage Integrated, Inc. totaling \$47,130, excluding claims for damages and legal costs. The Company is rigorously defending itself. As the Company believes this complaint is without merit, the Company believes a financial loss is remote and therefore has not recorded a contingent liability for this matter in its financial statements.

In March 2007, Allstate Insurance Company, as subrogee of David Buell, filed a complaint in the Circuit Court for the County of Oakland in the state of Michigan against HoMedics, Inc. and Kronos with respect to damages related to a fire in the home of Mr. Buell which resulted in \$244,155 in damages. In May, 2007 the case was transferred to United States District Court, in the Eastern District of Michigan. In December 2007, all the parties agreed to full resolution of this matter without any admission of liability by Kronos and without any payments by Kronos. Kronos obtained a full release from Allstate. In January 2008, the District Court dismissed the case as to Kronos with prejudice.

### NOTE 10 - SUBSEQUENT EVENTS

In January 2008, we received an additional advance of \$475,000 from AirWorks and Hilltop under the terms of the Funding Agreement and related notes.

In January 2008, we received an additional advance of \$300,000 from AirWorks under the terms of the Funding Agreement, related notes and a supplemental bridge financing letter, pursuant to which Kronos is obligated to repay the applicable amounts to AirWorks, at their sole discretion, from the proceeds of a customer transaction.

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## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

### INTRODUCTORY STATEMENTS

### FORWARD LOOKING STATEMENTS AND ASSOCIATED RISKS

THIS REPORT CONTAINS FORWARD-LOOKING STATEMENTS, INCLUDING STATEMENTS REGARDING, AMONG OTHER THINGS: (A) OUR PROJECTED SALES AND PROFITABILITY, (B) OUR GROWTH STRATEGIES, (C) ANTICIPATED TRENDS IN OUR INDUSTRY, (D) OUR FUTURE FINANCING PLANS, (E) OUR ANTICIPATED NEEDS FOR WORKING CAPITAL, AND (F) THE BENEFITS RELATED TO OUR OWNERSHIP OF KRONOS AIR TECHNOLOGIES, INC. IN ADDITION, WHEN USED IN THIS FILING, THE WORDS "BELIEVES," "ANTICIPATES," "INTENDS," "IN ANTICIPATION OF," "EXPECTS," AND SIMILAR WORDS ARE INTENDED TO IDENTIFY FORWARD-LOOKING STATEMENTS. THESE FORWARD-LOOKING STATEMENTS ARE BASED LARGELY ON OUR EXPECTATIONS AND ARE SUBJECT TO A NUMBER OF RISKS AND UNCERTAINTIES, MANY OF WHICH ARE BEYOND OUR CONTROL. ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THESE FORWARD-LOOKING STATEMENTS AS A RESULT OF VARIOUS FACTORS, INCLUDING, WITHOUT LIMITATION, THE RISKS OUTLINED UNDER "FACTORS AFFECTING KRONOS' BUSINESS AND PROSPECTS" AND MATTERS DESCRIBED IN THIS REPORT GENERALLY. IN LIGHT OF THESE RISKS AND UNCERTAINTIES, THERE CAN BE NO ASSURANCE THAT THE FORWARD-LOOKING STATEMENTS CONTAINED IN THIS REPORT WILL IN FACT OCCUR. WE DO NOT UNDERTAKE ANY OBLIGATION TO PUBLICLY RELEASE THE RESULTS OF ANY REVISIONS TO THESE FORWARD-LOOKING STATEMENTS THAT MAY BE MADE TO REFLECT ANY FUTURE EVENTS OR

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CIRCUMSTANCES.

### GENERAL

Kronos is a product development and production company that continues to develop and patent technology that, among other things, fundamentally changes the way air is moved, filtered and sterilized. Kronos is pursuing commercialization of its proprietary technology in a limited number of markets; and if we are successful and funds are available, we intend to enter additional markets in the future. The Company currently has thirteen U.S. patents and six international patents. To date, our ability to execute our strategy has been restricted by our limited amount of capital.

Kronos is focused on developing proprietary technology for air movement and purification applications to address the indoor air quality market. The Kronos technology has numerous valuable characteristics for applications in the indoor air quality market, including moving air and gases at high velocities while filtering odors, smoke and particulates and sterilizing air from bacteria and virus contamination. A number of the scientific claims of the Kronos technology have been tested by the U. S. and foreign governments, multi-national companies and independent testing facilities (see "Independent Testing - Product Claims Platform" below).

The Company has begun establishing strategic partners with select companies both domestically and internationally for standalone and embedded applications of our proprietary technology. The Company and its partners are in various stages of developing Kronos-based products.

### Technology Description and Benefits

The proprietary Kronos technology involves the management of corona discharge by applying high voltage management across paired electrical grids to create an ion exchange. Applications for efficient high voltage management, efficient corona discharge and ion exchange include but are not limited to:

- o air movement, including dielectric fluid movement and propulsion;
- o air purification, including particulate removal, bacteria and viral removal, biohazard destruction, and odor removal;
- o temperature and environmental management, including space heating and cooling;
- o microchip, MEMS and other electronics devices and components cooling;
- o air management, including sorting and separation of air streams by particle content;
- o sound generation, including high fidelity sound recreation and active noise cancellation;
- o high voltage management, including development of high voltage power supplies and control of energy surges and electrical discharges;
- o control of water and moisture content in air streams, including dehumidification and humidification; and
- o water treatment, including water purification, ionization and water desalination.

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### Independent Testing - Product Claims Platform

A number of the scientific claims of the Kronos technology have been tested by the U. S. and foreign governments, multi-national companies and independent testing facilities. To date, independent laboratory testing has verified the filtration and sterilization capability of the Kronos technology.

#### Filtration Testing Results:

- o Aerosol and Air Quality Research Laboratory - up to 99.8% filtration of 0.02 to 0.20 micron (20 to 200 nanometers) size particles;
- o LMS Industries - removal of over 99.97% of 0.10 micron (100 nanometers) and above size particles using HVAC industry's ASHRAE 52.2 testing standard for filtration;
- o MicroTest Laboratories - HEPA Clean Room Class 1000 quality particulate reduction; and
- o Intertek - tobacco smoke elimination tests in accordance with ANSI/AHAM AC-1-1988 standard entitled "American National Standard Method for Measuring Performance of Portable Household Electric Cord-Connected Room Air Cleaners," which demonstrated a Clean Air Delivery Rate ("CADR") for the Kronos air purifier of over 300 for the larger size Kronos air purifier and 80 for the smaller size using consumer filtration testing standards for the Association of Home Appliance Manufacturers ("AHAM").

#### Sterilization Testing Results:

- o Scientific Institution of Health Care, Central Clinical Hospital #2 in Moscow (clinical trial):
  - 100% decontamination of bacteria (*Staphylococcus aureus*) in under one hour and 80% decontamination of general bacteria in under 24 hours from a 48m(3) hospital room while people were present.
- o Pulmonary Department of Municipal Hospital #2 in Moscow (clinical trial):
  - 100% decontamination of bacteria (*Staphylococcus aureus*) in under five hours from a 66m(3) hospital room while four patients were present; and
  - 100% decontamination of mildew fungi in under two hours from a 113.2m(3) hospital room.
- o Disinfection Research Institute Sterilization Laboratory in Moscow:
  - disinfected a room completely contaminated with Bacteriophage
  - a microorganism which lives in the *E. Coli* bacteria. (Bacteriophage is widely used in virus testing because the microorganism's biological structure and size share many functional similarities with a wide range of viruses); and
  - 100% decontamination of room infected with bacteria (*Staphylococcus aureus* strain 906 (*S. aureus*) and *Bacillus cereus* strain 96 (*B. cereus*))
  - *S. aureus* is a known cause of hospital-acquired infections,

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including skin lesions such as boils and furunculosis and more serious infections such as pneumonia and meningitis.

- o Institute for Veterinary Medicine in the Ukraine - destroy and sterilize air which had been inseminated with Anthrax and E.coli spores;
- o New Hampshire Materials Laboratory - up to 95% reduction of hazardous gases, including numerous carcinogens found in cigarette smoke;
- o Battelle PNNL - 95% destruction of Bg (anthrax simulant); and
- o Dr. Sergey Stoylar, a bacteriologist from the American Bacteriological Society - 100% destruction of Bacillus subtilis 168 (bacteria simulant).

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### Medical Product Approval

In September 2006, the Russian Research Institute of Medical Equipment approved EOL's Kronos-based Tree air purification device for use in hospitals and other healthcare facilities. The device received Category I approval, which means the product has met the strictest regulations required for a device to be used in operating rooms and other areas that require a sterile environment. In November 2006, following the Russian Research Institute approval, the Ministry of Health Care and Social Development of the Russian Federation issued a Registration Certificate that designates the Kronos-based Tree air purification device for medical use.

### Market Segmentation

Kronos' initial business development strategy is to develop and produce products based on the Kronos technology to six distinct air quality market segments: (1) air movement and purification (residential, health care, hospitality, and commercial facilities); (2) air purification for unique spaces (clean rooms, airplanes, automotive, and cruise ships); (3) embedded cooling and cleaning (electronic devices and medical equipment); (4) specialized military (naval vessels, closed vehicles and mobile facilities); (5) industrial scrubbing (produce storage and diesel and other emissions); and (6) hazardous gas destruction (incineration and chemical facilities).

Kronos' current focus is on the first three of these market segments, which are described in more detail below:

- o Air Movement and Purification - Indoor air pollution, including sick building syndrome, second hand cigarette smoke and various bacterial and viral contaminants, is primarily caused by inadequate ventilation, chemical contaminants from indoor and outdoor sources and biological contaminants. There is also a demand for smaller devices that move, heat and deodorize the indoor air stream. The addressable air movement and purification segment is made up of four principal target markets: (1) residential, (2) health care, (3) hospitality and (4) commercial facilities.
- o Air Purification for Unique Spaces - Electronics, semiconductor, pharmaceutical, aerospace, medical and many other producers depend on clean room technology. As products, such as electronic devices become smaller, the chance of contamination in manufacturing becomes higher. For pharmaceutical companies, clean, safe and contaminant-free products are imperative to manufacturing and distributing a viable

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product. Other potential applications for the Kronos technology include closed environments, such as automobiles, aircraft, cruise ships and other transportation modes, that require people to breathe contaminated, re-circulated air for extended periods.

- o Embedded Cooling - Heat generation is becoming a major bottleneck in high density electronics. We believe that the embedded cooling market segment offers Kronos a near term opportunity to develop an alternative to fans for air movement and cooling inside of personal computers, servers and medical diagnostic equipment and a long term opportunity to develop micro channel cooling solutions for future generation microchips.

Kronos is currently developing products for the air movement and purification and air purification for unique spaces markets through specific customer contracts. Kronos is currently undertaking research and development in the embedded micro cooling market using Company funds and third party grants. These contracts and grants are described in more detail in the Technology Application and Product Development section of this filing.

### Technology Application and Product Development

To best serve Kronos' targeted market segments, our Company is developing specific product applications across two distinct product application platforms. A Kronos device can be either used as a standalone product or can be embedded. Standalone products are self-contained and only require the user to plug the Kronos device into a wall outlet to obtain air movement and filtration for their home, office or hotel room. Embedded applications of the Kronos technology require the technology be added into another system, such as a building ventilation system for more efficient air movement and filtration or into an electrical device such as computer or medical equipment to replace the cooling fan or heat sink.

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### Standalone Platform

Residential Products. In October 2007, Kronos executed a Letter of Intent for the development, manufacture and sale of air purification devices based upon Kronos' proprietary air movement and purification technology with a leading national retailer. It is expected that Kronos and the retailer would enter into a definitive purchase and supply agreement providing for the exclusive sale of private label residential standalone air purifiers through the retailer's distribution channels. Actual purchases of the products are dependent on the successful development of the product, the negotiation of a definitive purchase and supply agreement incorporating the terms of the letter of intent, other usual and customary terms and the retailers' discretion. Under the terms of the Letter of Intent, the retailer has paid Kronos \$250,000 towards the development costs of the new products and will contribute marketing resources to assist in the product development process. The intent of the parties is for Kronos to lead and manage all development, production and manufacturing activities for the Kronos air purifier and for the retailer to actively market the Kronos air purifier through their distribution channels. In December 2007, Kronos completed design and developed of an Alpha Prototype for the customer. In January 2008, the parties initiated negotiations of a definitive Product Development and Purchase Agreement. During the six months ended December 31, 2007, Kronos earned \$250,000 in product development fees.

Medical Products. In December 2005, the Company executed a non-exclusive license agreement with EOL LLC, a Russian Federation company ("EOL"), for manufacturing and distributing Kronos-based commercial standalone products in Russia and other select Commonwealth of Independent States. The initial medical products are

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currently being marketed in Russia and Ukraine and marketing plans are being implanted in, Kazakhstan, Moldova and Byelorussia. In November 2006, the Ministry of Health Care and Social Development of the Russian Federation issued a Registration Certificate for the product that designates the product for medical use. During the fiscal year ended June 30, 2007, Kronos earned \$104,000 in revenue from the sale of power supplies, other electrical components and engineering services and from the royalty from the sale of finished products by EOL. During the six months ended December 31, 2007, Kronos earned \$35,000 in revenue from licensing fees.

In August 2006, the Russian Research Institute of Medical Equipment began the process for product certification of the EOL's Kronos-based Tree air purification device for use in medical facilities, including a successful clinical trial of EOL products in the Pulmonary Department of Municipal Hospital #2 in Moscow. In October 2006, Scientific Institution of Health Care, Central Clinical Hospital #2 in Moscow completed a second clinical trial. As a result of these clinical trials, the Russian Research Institute approved the Kronos-based Tree air purification device for use in hospitals and other healthcare facilities. The device received Category I approval, which means the product has met the strictest regulations required for a device to be used in operating rooms and other areas that require a sterile environment. In November 2006, following the Russian Research Institute approval, the Ministry of Health Care and Social Development of the Russian Federation issued a Registration Certificate that designates the Kronos-based Tree air purification device for medical use.

The Company is in discussions to enter the U.S. medical market with one or more medical products distribution companies.

Commercial and Other Standalone Products. Utilizing our expanded product development resources, Kronos completed the initial design, development and production of a series of small multifunctional devices that can be used as space heaters, vaporizers, disinfectors, deodorizers and/or fans. Based on the proprietary Kronos technology, these devices are currently undergoing testing and evaluation. Kronos has been meeting with potential strategic partners for manufacturing, marketing, selling and distributing these Kronos-based products.

### Embedded Platform

Residential Products. In October 2006, a leading global home appliance manufacturer committed to fund 20% of the cost for Kronos to manufacturer a silent kitchen range hood product. This next generation range hood device represented the culmination of more than twelve months of product design and development effort by Kronos to apply our technology to this unique embedded residential application. The product was shipped to the customer in October 2006. In January 2007, the prototype design was modified based on customer input and a revised unit was shipped to the customer. In addition to financial support, the customer has also provided Kronos with product components for Kronos testing and evaluation. In February 2007, a second global appliance manufacturer committed to purchase additional prototypes from Kronos. During the year ended June 30, 2007, Kronos earned \$37,000 in revenue from the development of prototype devices for the residential range hood market place. In October 2007, Kronos shipped the additional prototypes to the customer for testing and evaluation. During the six months ended December 31, 2007, Kronos earned \$34,000 in product development fees.

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Commercial Products. In June 2006, the Company executed its first license for embedded applications of Kronos technology with DESA LLC ("DESA"). The agreement provides DESA the opportunity to embed the Kronos electrostatic air movement technology within fireplaces, hearth systems, zone heaters and mounted electric

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fans and heaters. In October 2006, DESA approved Kronos' designs for the first Kronos-based product and committed to the funding of the product development by Kronos. In January 2007, DESA committed additional funds for Kronos exploration of a second Kronos-based product application. By May 2007, various prototype configurations for each of the two product applications were under test and evaluation by Kronos and DESA. During the six months ended December 31, 2007, Kronos and DESA developed a plan for product commercialization. During the six months ended December 31, 2007, Kronos and DESA developed a plan for product commercialization, which the Company has not begun implementing pending the prioritization of resources.

In addition, Kronos has developed an air filtration and purification mechanism capable of performing to HEPA quality standards, while eliminating bacteria and viruses. The Company believes that Kronos devices could replace current HEPA filters with a permanent, easily cleaned, low-cost solution. Among the technical advantages of the Kronos technology over HEPA filters is the ability of the Kronos-based devices to eliminate the energy burden on air handling systems, which must generate high levels of backpressure necessary to move air through HEPA-based systems. Kronos-based devices enhance the air flow while providing better than HEPA level filtration and purification. Kronos is seeking one or more strategic partners to commercialize, market and distribute Kronos based commercial embedded air filtration and purification devices.

Transportation Products. In April 2006, Kronos was invited to serve as a member and an industrial partner in the Federal Aviation Administration's (the "FAA") Air Transportation Airliner Cabin Environment Research Center of Excellence. In this capacity, Kronos is providing its real-time decontamination, air filtration, purification and technology expertise to evaluate and develop solutions that proactively address and improve cabin air quality. The program, led by the FAA, includes senior executives from aerospace equipment manufacturers and leading American universities.

Microelectronics Cooling Products. In December 2004, Kronos and the University of Washington were awarded a Phase I grant for a research and technology development project entitled "Heat Transfer Technology for Microelectronics and MEMS" by the Washington Technology Center (the "WTC"). The objective of the project is to develop a novel energy-efficient heat transfer technology for cooling microelectronics. In January 2006, Kronos and the University of Washington conducted a successful bench scale demonstration of micron cooling of a MEMS chip. In June 2006, the Company and the University of Washington were awarded a Phase II grant for continued funding in its novel cooling system for microelectronics and computer chips. The WTC contributed \$100,000 as a Phase II grant for the project. Kronos provided \$35,000 in funding and \$38,000 in in-kind services, including use of the Kronos Research and Product Development Facility. Dr. Alexander Mamishev of the University of Washington Electrical Engineering Department is the principal investigator on the project and is leading a team of scientists and engineers from Kronos and Intel Corporation who are also collaborating on the project. In September 2006, Kronos hired a former Intel employee to lead Kronos' development of micro cooling applications. In June 2007, the Company and the University of Washington were awarded a Phase III grant for continued funding. This additional funding is to support the further development of prototype products. The WTC is contributing \$100,000. Kronos will provide \$20,000 in funding and \$20,000 in in-kind services, including use of the Kronos Research and Product Development Facility.

Thermal management for microelectronics and MEMS systems is a challenge. Existing cooling devices aren't meeting increasing needs for energy consumption and heat dissipation. Kronos air handling technology is an emerging technology that uses an electric field to exert force on ionized gas. Kronos is attempting to develop an improved microchip air handling system that is smaller in size, has high speed airflow, allows more targeted delivery of cooling to areas of highest heat and is compatible with current processes. Patents and Intellectual

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### Property

Kronos currently has thirteen registered patents with the United States Patent and Trademark Office and six international patents. These patents are considered utility patents which describe fundamental innovations in the generation, management and control of electrostatic fluids, including air movement, filtration and purification. Each of the patents contain multiple part claims for both general principles as well as specific designs for incorporating the Kronos technology into air movement, filtration and purification products. The patents provide protection for both specific product implementations of the Kronos technology, as well as more general processes for applying the unique attributes and performance characteristics of the technology.

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### U.S. Patents

| Date<br>----     | U.S. Patent #<br>----- | Patent Title<br>-----                                        | Description<br>-----                                                                                                                    | Protecti<br>----- |
|------------------|------------------------|--------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------|-------------------|
| August<br>2007   | 7,262,564              | Alternative Geometries and Voltage Supply Management         | geometry, voltage ratios and power requirements for improved operational performance                                                    | 202               |
| July<br>2007     | 7,248,003              | Electric Field Management                                    | effective electric field management for reduced sparking                                                                                | 202               |
| October<br>2006  | 7,122,070              | Method of and Apparatus for Electrostatic Fluid Acceleration | inertialess power supply for safe operation and spark prevention                                                                        | 202               |
| August<br>2006   | 7,157,704              | Corona Discharge Electrode and Method of Operating           | method of generating air flow and air cleaning with reduced amount of ozone by-product and with extended life-span of the electrodes    | 202               |
| July<br>2006     | 7,150,780              | Electrostatic Air Cleaning Device                            | method for improving the efficiency of electrodes for filtering micron and sub-micron size particles                                    | 202               |
| May<br>2006      | 7,053,565              | Electrostatic Fluid Accelerator - Power Management           | effective powering of the electrodes for high level of air velocity                                                                     | 202               |
| November<br>2005 | 6,963,479              | Electrostatic Fluid Accelerator - Advanced Geometries        | advanced voltage management impacts air filtration and sterilization, air flow and ozone as well as safe operation and spark prevention | 202               |
| August<br>2005   | 6,937,455              | Spark Management Method and Device                           | analysis, detection and prevention of sparks in a                                                                                       | 202               |

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|                  |           |                                                                                                  |                                                                                                                                                                              |      |
|------------------|-----------|--------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------|
|                  |           |                                                                                                  | high voltage field -<br>creating safe, effective<br>electrostatic technology<br>products                                                                                     |      |
| July<br>2005     | 6,919,698 | Voltage Management<br>for Electrostatic<br>Fluid Accelerator                                     | materials and geometry<br>allowing for spark free<br>operation and use of light<br>weight, inexpensive                                                                       | 202  |
| May<br>2005      | 6,888,314 | Electrostatic Fluid<br>Accelerator -<br>Electrode Design<br>Geometries                           | materials as the electrodes<br>electrode design geometries<br>and attributes including<br>micro channeling to achieve<br>unique air movement and<br>purification performance | 202  |
| April<br>2004    | 6,727,657 | Electrostatic Fluid<br>Accelerator for and<br>a Method of<br>Controlling Fluid                   | synchronization of multiple<br>stages of arrays -<br>increasing air flow and air<br>flow efficiency                                                                          | 202  |
| December<br>2003 | 6,664,741 | Method of and<br>Apparatus for<br>Electrostatic Fluid<br>Acceleration Control<br>of a Fluid Flow | ratio of voltage for<br>producing ion discharge to<br>create air movement and<br>base level filtration                                                                       | 2022 |
| January<br>2003  | 6,504,308 | Electrostatic Fluid<br>Accelerator                                                               | electrode density core for<br>producing ion discharge to<br>create air movement and<br>base level filtration                                                                 | 2019 |

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### International Patents

Kronos has received formal notification from the Canadian Intellectual Property Office, the Mexican Institute of Industrial Property, Commonwealth of Australia Patent Office, the Intellectual Property Office of New Zealand and the Ukrainian Patent Office indicating that one or more patents have been examined and allowed for issuance as patents. There are a number of other patent applications corresponding to Kronos' thirteen U.S. Patents that have been filed and are pending outside of the United States.

Kronos intends to continue to aggressively file patent applications in the U.S. and internationally. A number of additional patent applications have been filed for, among other things, the control and management of electrostatic fluid acceleration. These additional patent applications are either being examined or are awaiting examination by the Patent Office.

### CRITICAL ACCOUNTING POLICIES

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and

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expenses during the reporting period. Actual results could differ from those estimates.

**Allowance for Doubtful Accounts.** We provide a reserve against our receivables for estimated losses that may result from our customers' inability to pay. These reserves are based on potential uncollectible accounts, aged receivables, historical losses and our customers' credit-worthiness. Should a customer's account become past due, we generally will place a hold on the account and discontinue further shipments and/or services provided to that customer, minimizing further risk of loss.

**Valuation of Goodwill, Intangible and Other Long Lived Assets.** We use assumptions in establishing the carrying value, fair value and estimated lives of our long-lived assets and goodwill. The criteria used for these evaluations include management's estimate of the asset's ability to generate positive income from operations and positive cash flow in future periods compared to the carrying value of the asset, the strategic significance of any identifiable intangible asset in our business objectives, as well as the market capitalization of Kronos. We have used certain key assumptions in building the cash flow projections required for evaluating the recoverability of our intangible assets. We have assumed revenues from the following applications of the Kronos technology: consumer stand-alone devices, assisted care/skilled nursing stand-alone devices, embedded devices in the hospitality industry and in specialized military applications. Expenses/cash out flows in our projections include sales and marketing, production, distribution, general and administrative expenses, research and development expenses and capital expenditures. These expenses are based on management estimates and have been compared with industry norms (relative to sales) to determine their reasonableness. We use the same key assumptions for our cash flow evaluation as we do for internal budgeting, lenders and other third parties; therefore, they are internally and externally consistent with financial statement and other public and private disclosures. We are not aware of any negative implications resulting from the projections used for purposes of evaluating the appropriateness of the carrying value of these assets. If assets are considered to be impaired, the impairment recognized is the amount by which the carrying value of the assets exceeds the fair value of the assets. Useful lives and related amortization or depreciation expense are based on our estimate of the period that the assets will generate revenues or otherwise be used by Kronos.

Factors that would influence the likelihood of a material change in our reported results include significant changes in the asset's ability to generate positive cash flow, loss of legal ownership or title to the asset, a significant decline in the economic and competitive environment on which the asset depends, significant changes in our strategic business objectives, and utilization of the asset.

**Valuation of Deferred Income Taxes.** Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. The likelihood of a material change in our expected realization of these assets is dependent on our ability to generate future taxable income, our ability to deduct tax loss carryforwards against future taxable income, the effectiveness of our tax planning and strategies among the various tax jurisdictions that we operate in, and any significant changes in the tax treatment received on our business combinations.

**Revenue Recognition.** We recognize revenue in accordance with Securities and Exchange Commission Staff Bulletin 104 ("SAB 104"). Further, Kronos Air Technologies recognizes revenue on the sale of custom-designed contract sales under the percentage-of-completion method of accounting in the ratio that costs incurred to date bear to estimated total costs. For uncompleted contracts where costs and estimated profits exceed billings, the net amount is included as an asset in the consolidated balance sheet. For uncompleted contracts where

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billings exceed costs and estimated profits, the net amount is included as a liability in the consolidated balance sheet. Sales are reported net of applicable cash discounts and allowances for returns.

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### RESULTS OF OPERATIONS

Consolidated Statement of Operations For the Quarter Ended December 31, 2007 Compared with the Quarter Ended December 31, 2006.

Our net losses for each of the six months ended December 31, 2007 and 2006 were \$3,471,000 and \$1,714,000, respectively. The \$1,757,000, or 103%, increase in the net loss for the six months ended December 31, 2007, as compared to the prior year was principally the result of a \$1,173,000 in accretion of note discount, a \$585,000, or 37%, increase in operating costs to \$2,155,000, and \$145,000, or 83%, increase in interest expense, partially offset by a \$146,000, or 487%, increase in gross profit to \$175,000.

Revenue. Revenues are generated through sales of services for design and development of Kronos devices at Kronos Air Technologies, Inc. Revenues for the six months ended December 31, 2007 were \$319,000 compared with \$121,000 for the comparable period in the prior year, an increase of \$198,000, or 164%. Revenues for the six months ended December 31, 2007 were from our agreements with a national retailer, global consumer products company and EOL. In comparison, revenues for the six months ended December 31, 2006 were from our agreements with EOL, GE and DESA.

Cost of Sales. Cost of sales for the six months ended December 31, 2007 was \$144,000 compared with \$92,000 for the prior year, and increase of \$52,000, or 57%. Cost of sales for the six months ended December 31, 2007 were primarily product development costs associated with our national retailer and global consumer products company agreements. In comparison, cost of goods sold for the six months ended December 31, 2006 were primarily product development costs associated with our EOL, GE and DESA agreements.

Selling, General and Administrative Expenses. Selling, General and Administrative expenses for the six months December 31, 2007 increased \$585,000, or 37%, from the corresponding period of the prior year to \$2,155,000. The increase was principally the result of a \$405,000 increase in compensation and benefits primarily as a result of an increase in the expense of amortizing stock options that vested during the 2007 period and a \$175,000, or 95%, increase in professional services as a result of an increase in advisory services from our majority shareholder and legal expenses.

Accretion of note discount. Accretion of note discount for the six months ended December 31, 2007 of \$1,173,000 represented the amortization of the beneficial conversion feature of the AirWorks and Hilltop promissory notes.

Interest expense. Interest expenses for the six months ended December 31, 2007 was \$319,000 compared to \$174,000 for the corresponding period of the prior year. The \$145,000, or 83%, increase in interest expense for the six months December 31, 2007, as compared to the prior year, was principally the result of the interest on promissory notes payable to AirWorks, Hilltop, Sands and Critical Capital.

Consolidated Balance Sheet as of December 31, 2007 Compared with June 30, 2007

Our total assets at December 31, 2007 were \$1,999,000 compared with \$2,111,000 at June 30, 2007. Total assets at December 31, 2007 and June 30, 2007 were comprised primarily of \$1,719,000 and \$1,723,000, respectively, of

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patents/intellectual property and \$212,000 and \$364,000, respectively, of cash. Total current assets at December 31, 2007 and June 30, 2007 were \$270,000 and \$381,000, respectively, while total current liabilities for such periods were \$1,926,000 and \$1,589,000, respectively. This created a working capital deficit of \$1,656,000 and \$1,208,000 at December 31, 2007 and June 30, 2007, respectively. This working capital deficit is primarily due to short term borrowings from Sands Brothers.

Stockholders' deficit as of December 31, 2007 was \$2,032,000. The \$3,471,000 net loss for the six months ended December 31, 2007 was partially offset by the issuance of equity from the conversion of promissory notes into stock (\$731,000), the issuance of stock options for services (\$397,000), and the issuance of stock for services (\$24,000).

### LIQUIDITY AND CAPITAL RESOURCES

Historically, we have relied principally on the sale of common stock and secured debt and customer contracts for research and product development to finance our operations.

Net cash flow used in operating activities was \$1,365,000 for the six months ended December 31, 2007. We were able to satisfy our cash requirements for this period from the proceeds of the convertible secured promissory notes with AirWorks and Hilltop and customer revenue from product development and licensing fees.

We estimate that achievement of our business plan will require substantial additional funding. We anticipate that the source of funding will be obtained pursuant to equity funding from the Funding Agreement described below. There are no assurances that these sources of funding will be available to the Company or adequate to meet our cash flow needs.

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In June 2007, Kronos entered into a Funding Agreement with a group of lenders providing for a loan, at the discretion of the lenders, in the aggregate amount of up to \$18,159,000. At the initial closing, the Company received an initial advance of \$4,259,000. After payment in full of the amounts due under an outstanding convertible debenture issued to Cornell Capital Partners and the settlement agreement obligation to HoMedics and the expenses of the transaction, the remainder of \$1,069,000 was used for working capital purposes. The initial new lenders under the Funding Agreement were: (i) AirWorks Funding LLLP, a newly-formed limited partnership; (ii) Critical Capital Growth Fund, L.P. and various Sands Brothers Venture Funds, all of which are affiliates of Laidlaw and Co. (UK) Ltd. and (iii) RS Properties I LLC, a New York-based private investment company. Subsequently, RS Properties assigned to Hilltop its promissory note in the amount of \$6,480,000, together with certain other rights and agreements relating thereto, including, without limitation, its rights and obligations under the Funding Agreement. During the six months ended December 31, 2007, the Company received an additional \$1,430,000 in funding under the terms of the Funding Agreement and related notes. In January 2008, we received an additional advance of \$475,000 from AirWorks and Hilltop under the terms of the Funding Agreement and related notes and an additional advance of \$300,000 from AirWorks under the terms of the Funding Agreement, related notes and a supplemental bridge financing letter, pursuant to which Kronos is obligated to repay the applicable amounts to AirWorks, at their sole discretion, from the proceeds of a customer transaction.

The loan is secured by all of the Company's assets and is convertible into shares of the Company's common stock at a conversion price of \$0.003 per share, subject to adjustment under certain circumstances. Future installments under the

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Funding Agreement, up to \$12,470,000, may be advanced at the discretion of the lenders, even if not requested by the Company. Under the Funding Agreement and related notes, the Company pays interest on the notes at the rate of 12% per annum. Of the total amount of the initial advance, monthly interest payments commenced on July 1, 2007 on principal of \$859,000, which was initially due and payable on December 31, 2007. In December 2007, Critical Capital and Sands Brothers agreed to extend the maturity date until February 28, 2008. The outstanding amounts may be converted into Kronos common stock at the option of the holder at the \$0.003 conversion price only if not paid in full by February 28, 2008. With respect to all other loan amounts, interest is paid quarterly starting January 1, 2008 and outstanding principal is due and payable June 19, 2010, unless earlier converted at the option of the lenders. Assuming payment when due of the \$859,000, that the maximum loan amount is advanced under the Funding Agreement and related notes and that the lenders convert the entire amount of the loan into Kronos common stock at the noted conversion price, the lenders would own approximately 93.3% of the Company's total equity on a fully diluted, as converted basis. In December 2007, AirWorks and Hilltop converted \$731,440 of their Secured Convertible Promissory Notes into 243,813,400 shares of Kronos common stock resulting in a change in control of Kronos.

### GOING CONCERN OPINION

The Report of Independent Registered Public Accounting Firm for the years ended June 30, 2007 and 2006 included an explanatory paragraph that stated that we do not have significant cash or other material assets to cover our operating costs. Our ability to obtain additional funding will largely determine our ability to continue in business. Accordingly, there is substantial doubt about our ability to continue as a going concern. Our consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

We can make no assurance that we will be able to successfully develop, manufacturer and sell commercial products on a broad basis. While attempting to make this transition, we will be subject to all the risks inherent in a growing venture, including, but not limited to, the need to develop and manufacture reliable and effective products, develop marketing expertise and expand our sales force.

### FACTORS AFFECTING KRONOS' BUSINESS AND PROSPECTS

We are subject to various risks which may have a material adverse effect on our business, financial condition and results of operations, and may result in a decline in our stock price. Certain risks are discussed below:

We do not have sufficient cash to continue operations and require significant additional financing to sustain our operations.

At December 31, 2007 and June 30, 2007, we had a working capital deficit of \$1,656,000 and \$1,208,000, respectively. The Report of Independent Registered Public Accounting Firm for the year ended June 30, 2007, includes an explanatory paragraph to their audit opinion stating that our recurring losses from operations and working capital deficiency raise doubt about our ability to continue as a going concern. For the six months ended December 31, 2007 and the fiscal year ended June 30, 2007, we had an operating cash flow deficit of \$1,365,000 and \$3,029,000 and a cash balance of \$212,000 and \$364,000, respectively. Funding may be available to Kronos through AirWorks and Hilltop. However, Kronos has not determined if this funding will be sufficient, because the lenders, at their sole discretion, control the timing of and whether such funding will occur.

We have a limited operating history with significant losses and expect losses to

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continue for the foreseeable future.

We have only recently begun implementing our plan to prioritize and concentrate our management and financial resources to fully capitalize on our investment in Kronos Air Technologies and have yet to establish any history of profitable operations. We incurred a net loss of \$3,471,000 for the six months ended December 31, 2007 and a net loss of \$2,351,000 for the fiscal year ended June 30, 2007. As a result, at December 31, 2007 and June 30, 2007, we had an accumulated deficit of \$36,940,000 and \$33,469,000, respectively. Our revenues and cash flows from operations have not been sufficient to sustain our operations. We have sustained our operations through the issuance of our common stock and the incurrence of debt. We expect that our revenues and cash flows from operations will not be sufficient to sustain our operations for the foreseeable future. Our profitability will require the successful commercialization of our Kronos technologies. No assurances can be given that we will be able to successfully commercialize our Kronos technologies or that we will ever be profitable. If we do not achieve profitability we could be forced to curtail or cease our business operations.

Existing stockholders will experience significant dilution from our sale of shares under any equity financing.

The sale of shares pursuant to the conversion of the AirWorks and Hilltop Secured Convertible Promissory Note, the exercise of stock options and warrants or any other future equity financing transaction will have a dilutive impact on our stockholders. As a result, our net income per share could decrease in future periods, and the market price of our common stock could decline. In December 2007, AirWorks and Hilltop converted \$731,440 of their Secured Convertible Promissory Notes into 243,813,400 shares of Kronos common stock resulting in a change in control of Kronos and dilution to the Company's existing stockholders.

Competition in the market for air movement and purification devices may result in the failure of the Kronos products to achieve market acceptance.

Kronos presently faces competition from other companies that are developing or that currently sell air movement and purification devices. Many of these competitors have greater financial, research and development, manufacturing, and sales and marketing resources than we do. Many of the products sold by Kronos' competitors already have brand recognition and established positions in the markets that we have targeted for penetration. In the event that the Kronos products do not favorably compete with the products sold by our competitors, we would be forced to curtail or cease our business operations.

Our failure to enforce protection of our intellectual property would have a material adverse effect on our business.

A significant part of our success depends in part on our ability to obtain and defend our intellectual property, including patent protection for our products and processes, preserve our trade secrets, defend and enforce our rights against infringement and operate without infringing the proprietary rights of third parties, both in the United States and in other countries. Our limited amount of capital impedes our current ability to protect and defend our intellectual property. The validity and breadth of our intellectual property claims in ion wind generation and electrostatic fluid acceleration and control technology involve complex legal and factual questions and, therefore, may be highly uncertain. Despite our efforts to protect our intellectual proprietary rights, existing copyright, trademark and trade secret laws afford only limited protection. Our industry is characterized by frequent intellectual property litigation based on allegations of infringement of intellectual property rights. Although we are not aware of any intellectual property claims against us, we may be a party to litigation in the future. If we are unable to enforce protection of our intellectual property, we could be forced to curtail or cease our

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business operations.

Possible future impairment of intangible assets would have a material adverse effect on our financial condition.

Our net intangible assets of approximately \$1,719,000 as of December 31, 2007 consist principally of purchased patent technology and marketing intangibles, which relate to the acquisition of Kronos Air Technologies, Inc. in March 2000 and to the acquisition of license rights to fuel cell, computer and microprocessor applications of the Kronos technology not included in the original acquisition of Kronos Air Technologies, Inc. in May 2003 and capitalized legal costs for securing patents. Intangible assets comprise 86% of our total assets as of December 31, 2007. Intangible assets are subject to periodic review and consideration for potential impairment of value. Among the factors that could give rise to impairment include a significant adverse change in legal factors or in the business climate, an adverse action or assessment by a regulator, unanticipated competition, a loss of key personnel, and projections or forecasts that demonstrate continuing losses associated with these assets. In the case of our intangible assets, specific factors that could give rise to impairment would be, but are not limited to, an inability to obtain patents, the untimely death or other loss of Dr. Igor Krichtafovitch, the lead inventor of the Kronos technology and Kronos Air Technologies Chief Technology Officer, or the ability to create a customer base for the sale Kronos-based products. Should an impairment occur, we would be required to recognize it in our financial statements. A write-down of these intangible assets could have a material adverse impact on our total assets, net worth and results of operations.

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Our common stock is deemed to be "Penny Stock," subject to special requirements and conditions and may not be a suitable investment.

Our common stock is deemed to be "penny stock" as that term is defined in Rule 3a51-1 promulgated under the Securities Exchange Act of 1934. Penny stocks are stocks: (i) With a price of less than \$5.00 per share; (ii) That are not traded on a "recognized" national exchange; or (iii) In issuers with net tangible assets less than \$2,000,000 (if the issuer has been in continuous operation for at least three years) or \$5,000,000 (if in continuous operation for less than three years), or with average revenues of less than \$6,000,000 for the last three years.

Broker/dealers dealing in penny stocks are required to provide potential investors with a document disclosing the risks of penny stocks. Moreover, broker/dealers are required to determine whether an investment in a penny stock is a suitable investment for a prospective investor. These requirements may reduce the potential market for our common stock by reducing the number of potential investors. This may make it more difficult for investors in our common stock to resell shares to third parties or to otherwise dispose of them. This could cause our stock price to decline.

We rely on management and research personnel, the loss of whose services could have a material adverse effect upon our business.

We rely principally upon the services of our senior executive management, and certain key employees, including the Kronos research and product development team, the loss of whose services could have a material adverse effect upon our business and prospects. Competition for appropriately qualified personnel is intense. Our ability to attract and retain highly qualified senior management and technical research and product development personnel are believed to be an

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important element of our future success. Our failure to attract and retain such personnel may, among other things, limit the rate at which we can expand operations and achieve profitability. There can be no assurance that we will be able to attract and retain senior management and key employees having competency in those substantive areas deemed important to the successful implementation of our plans to fully capitalize on our investment in the Kronos technology, and the inability to do so or any difficulties encountered by management in establishing effective working relationships among them may adversely affect our business and prospects. Currently, we do not carry key person life insurance for any of our executive management, or key employees.

### ITEM 3. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. As of June 30, 2007, the Company carried out an evaluation, under the supervision and with the participation of the Company's Principal Officer/Principal Financial Officer, of the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act")) pursuant to Rule 13a-15 of the Exchange Act. It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. Based on that evaluation, the Company's management, including the Company's Principal Executive Officer/Principal Financial Officer, concluded that the Company's disclosure controls and procedures were ineffective at this reasonable assurance level as of June 30, 2007.

Changes in Internal Controls over Financial Reporting. In connection with the evaluation of the Company's internal controls over financial reporting during the Company's fiscal year ended June 30, 2007, the Company's Principal Executive Officer/Principal Financial Officer has determined that there were no changes to the Company's internal controls over financial reporting during the fourth quarter that have materially affected or is reasonably likely to affect the Company's internal control over financial reporting.

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## PART II

### ITEM 1. LEGAL PROCEEDINGS

From time to time the Company may be subject to law suits in the normal course of business.

In October 2006, Thompson E. Fehr filed a complaint in the Second Judicial District Court of Weber County in the state of Utah against Kronos with respect to prior services rendered to High Voltage Integrated, Inc. totaling \$47,130 excluding claims for damages and legal costs. The Company is rigorously defending itself. As the Company believes this complaint is without merit, the Company believes a financial loss is remote and therefore has not recorded a contingent liability for this matter in its financial statements.

In March 2007, Allstate Insurance Company, as subrogee of David Buell, filed a complaint in the Circuit Court for the County of Oakland in the state of Michigan against HoMedics, Inc. and Kronos with respect to damages related to a fire in the home of Mr. Buell which resulted in \$244,155 in damages. In May, 2007 the case was transferred to United States District Court, in the Eastern District of Michigan. In December 2007, all the parties agreed to full resolution of this matter without any admission of liability by Kronos and without any payments by Kronos. Kronos obtained a full release from Allstate. In January 2008, the District Court dismissed the case as to Kronos with prejudice.

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### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

In September 2007, we issued 1,470,588 shares of Kronos common stock to Cornell Capital Partners under our Standby Equity Distribution Agreement in payment of a past due commitment fee. We believe the issuance of such securities was exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to Section 4(2) thereof.

In December 2007, we issued 243,813,400 shares of Kronos common stock to AirWorks and Hilltop who converted \$731,440 under their Secured Convertible Promissory Notes. We believe the issuance of such securities was exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to Section 4(2) thereof.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On December 14, 2007, the Company's Board of Directors approved a reincorporation and recapitalization of the Company which will include (1) the Company being reincorporated in the State of Delaware via a reincorporation merger with a newly created subsidiary of the Company, (2) increasing the authorized share capital of the Company to 500,000,000,000 shares of common stock and 100,000,000 shares of preferred stock and (3) making certain other changes to the organizational documents of the Company. Effective December 31, 2007, and following the conversion of a portion of the AirWorks and Hilltop notes, a majority of the stockholders of the Company approved the reincorporation/ recapitalization by written consent. Prior to the effectiveness of the reincorporation/recapitalization, the Company will be distributing an information statement to its stockholders in accordance with Schedule 14C of the Securities and Exchange Act of 1934, as amended. Such information statement will include additional details regarding the reincorporation and recapitalization.

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### ITEM 6. EXHIBITS

| EXHIBIT NO. | DESCRIPTION                                                                                                                          | LOCATION                                                                                                                                               |
|-------------|--------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2.1         | Articles of Merger for Technology Selection, Inc. with the Nevada Secretary of State                                                 | Incorporated by reference to Exhibit 2.1 to the Registrant's Registration Statement on Form S-1 filed on August 7, 2001 (the "Registration Statement") |
| 3.1         | Articles of Incorporation                                                                                                            | Incorporated by reference to Exhibit 3.1 to the Registration Statement                                                                                 |
| 3.2         | Bylaws                                                                                                                               | Incorporated by reference to Exhibit 3.2 to the Registration Statement                                                                                 |
| 10.1        | Amendment No.1 to Kronos Advanced Technologies, Inc. Secured Convertible Promissory Note with Sands, et. al. dated December 31, 2007 | Incorporated by reference to Exhibit 10.1 to the Registrant's 8-K filed on January 7, 2008                                                             |

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- 31 Certification of Chief Executive Officer pursuant to U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 Provided herewith
  
- 32 Certification by Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 Provided herewith

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DATED: February 14, 2008 KRONOS ADVANCED TECHNOLOGIES, INC.

By: /s/ DANIEL R. DWIGHT  
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 Daniel R. Dwight  
 President, Chief Executive Officer and  
 Chief Financial Officer