

KRONOS ADVANCED TECHNOLOGIES INC  
Form 10QSB  
February 17, 2004

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-QSB

Quarterly Report Pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934

For the quarterly period ended December 31, 2003

Transition Report under Section 13 or 15(d)  
of the Securities Exchange Act of 1934

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

COMMISSION FILE NO. 000-30191

KRONOS ADVANCED TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

NEVADA

87-0440410

-----  
(State of other jurisdiction of  
incorporation or organization)

-----  
(I.R.S. Employer Identification Number)

464 Common Street, Suite 301, Belmont, MA

02478

-----  
(Address of principal executive offices)

-----  
(Zip Code)

Registrant's telephone number, including area code: (617) 993-9965

(1) Registrant has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and

(2) has been subject to such filing requirements for the past 90 days. /X/ Yes  
// No

As of February 5, 2004, there were 58,354,217 shares outstanding of the issuer's common stock.

PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

The following comprise our condensed (unaudited) consolidated financial statements for the three months and six months ended December 31, 2003.

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KRONOS ADVANCED TECHNOLOGIES, INC.  
CONSOLIDATED BALANCE SHEETS

|  | December 31, 2003<br>(Unaudited) | June 30, 2003 |
|--|----------------------------------|---------------|
|  | -----                            | -----         |
| Assets   |                                  |               |
| Current Assets   |                                  |               |
| Cash   | \$ 177,831                       | \$ 641,178    |
| Accounts receivable, net                                   | 22,505                           | 48,766        |
| Prepays  | 113,399                          | 34,135        |
|  | -----                            | -----         |
| Total Current Assets                                       | 313,735                          | 724,078       |
|  | -----                            | -----         |
| Net Property and Equipment                                 | 22,681                           | 28,042        |
|  | -----                            | -----         |
| Other Assets   |                                  |               |
| Intangibles  | 2,415,330                        | 2,487,473     |
|  | -----                            | -----         |
| Total Other Assets   | 2,415,330                        | 2,487,473     |
|  | -----                            | -----         |
| Total Assets   | \$ 2,751,746                     | \$ 3,239,594  |
|  | =====                            | =====         |
| Liabilities and Shareholders' Deficit                      |                                  |               |
| Current Liabilities  |                                  |               |
| Accrued expenses and payables<br>to directors and officers | \$ 1,206,528                     | \$ 1,172,015  |
| Accounts payable   | 84,796                           | 218,338       |
| Accrued expenses   | 175,675                          | 174,677       |
| Deferred revenue   | 64,069                           | 133,751       |
| Notes payable, current portion                             | 587,863                          | 185,670       |
|  | -----                            | -----         |
| Total Current Liabilities                                  | 2,118,931                        | 1,884,451     |
|  | -----                            | -----         |
| Long Term Liabilities                                      |                                  |               |
| Notes payable  | 2,057,288                        | 2,676,479     |
| Discount on notes<br>payable                               | (760,742)                        | (893,046)     |
|  | -----                            | -----         |
| Total Long Term Liabilities                                | 1,296,546                        | 1,783,433     |
|  | -----                            | -----         |
| Total Liabilities  | 3,415,477                        | 3,667,884     |
|  | -----                            | -----         |

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|  |              |              |
|--|--------------|--------------|
| Redeemable Warrants  | -            | 805,300      |
|  | -----        | -----        |
| Shareholders' Deficit  |              |              |
| Common stock, authorized 500,000,000 shares of \$0.001 par value - 57,956,182 and 53,836,524 shares outstanding on December 31 and June 30, 2003, respectively | 57,956       | 53,837       |
| Capital in excess of par value   | 17,926,610   | 16,240,378   |
| Accumulated deficit  | (18,648,297) | (17,527,805) |
|  | -----        | -----        |
| Total Shareholders' Deficit  | (663,731)    | (1,233,590)  |
|  | -----        | -----        |
| Total Liabilities and Shareholders' Deficit  | \$ 2,751,746 | \$ 3,239,594 |
|  | =====        | =====        |

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

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KRONOS ADVANCED TECHNOLOGIES, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS

|   | For the three months ended<br>December 31, |                     | For the si<br>De    |
|---|--|---------------------|---------------------|
|   | 2003<br>(Unaudited)                        | 2002<br>(Unaudited) | 2003<br>(Unaudited) |
|   | -----                                      | -----               | -----               |
| Sales   | \$ 111,528                                 | \$ 209,545          | \$ 241,545          |
| Cost of sales                                   | 73,052                                     | 33,179              | 155,805             |
| Gross Profit                                    | 38,476                                     | 176,366             | 85,740              |
|   | -----                                      | -----               | -----               |
| Selling, General and Administrative expenses    |  |                     |                     |
| Compensation and benefits                       | 209,724                                    | 130,944             | 412,547             |
| Research and development                        | 19,023                                     | 48,407              | 38,851              |
| Professional services                           | 73,646                                     | 402,852             | 117,284             |
| Depreciation and amortization                   | 70,465                                     | 70,793              | 141,044             |
| Facilities                                      | 25,837                                     | 26,009              | 44,710              |
| Other selling general & administrative expenses | 103,622                                    | 44,189              | 177,374             |
|   | -----                                      | -----               | -----               |
| Selling, General and Administrative expenses    | 502,317                                    | 723,194             | 931,810             |
|   | -----                                      | -----               | -----               |
| Net Operating Loss                              | (463,841)                                  | (546,828)           | (846,070)           |

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|                                     |              |            |                |
|-------------------------------------|--------------|------------|----------------|
| Other Income                        | 22,000       | 108,376    | 22,000         |
| Interest Expense                    | (128,152)    | (34,361)   | (296,422)      |
| Net Loss Before Taxes               | (569,993)    | (472,814)  | (1,120,492)    |
| Provision for Taxes                 | -            | -          | -              |
| Net Loss                            | \$ (569,993) | (472,814)  | \$ (1,120,492) |
| Basic Loss Per Share                | \$ (0.01)    | \$ (0.01)  | \$ (0.02)      |
| Diluted Loss Per Share              | \$ (0.01)    | \$ (0.01)  | \$ (0.02)      |
| Weighted average shares outstanding | 56,945,587   | 47,021,691 | 55,459,617     |

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

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KRONOS ADVANCED TECHNOLOGIES, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS

| CASH FLOWS FROM OPERATING ACTIVITIES                                  | For the six months ended December 31, |                     |
|---|---------------------------------------|---------------------|
|   | 2003<br>(Unaudited)                   | 2002<br>(Unaudited) |
| Net loss from operations  | \$ (1,120,492)                        | \$ (1,063,944)      |
| Adjustments to reconcile net loss to net cash provided by operations: |                                       |                     |
| Depreciation and amortization   | 141,044                               | 143,429             |
| Accretion of note discount  | 132,304                               | -                   |
| Common stock issued for compensation/services                         | 79,200                                | 101,859             |
| Change In:  |                                       |                     |
| Accounts receivable   | 26,261                                | (26,920)            |
| Prepaid expenses and other assets                                     | (79,264)                              | 51,205              |
| Deferred revenue  | (69,682)                              | 166,734             |
| Accounts payable  | (93,620)                              | 353,583             |

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|   |            |            |
|---|------------|------------|
| Accrued expenses and other liabilities                                | (4,410)    | 143,800    |
| Net cash used in operations   | (988,660)  | (130,255)  |
| CASH FLOWS FROM INVESTING ACTIVITIES                                  |            |            |
| Investment in patent protection                                       | (63,539)   | -          |
| Net cash used in investing activities                                 | (63,539)   | -          |
| CASH FLOWS FROM FINANCING ACTIVITIES                                  |            |            |
| Issuance of common stock  | 805,851    | 418,000    |
| Proceeds from short-term borrowings                                   | -          | 165,889    |
| Repayments of short-term borrowings                                   | (216,999)  | (311,700)  |
| Net cash provided by financing activities                             | 588,852    | 272,189    |
| NET (DECREASE) INCREASE IN CASH                                       | (463,347)  | 141,934    |
| CASH  |            |            |
| Beginning of period   | 641,178    | 21,510     |
| End of period   | \$ 177,831 | \$ 163,444 |
| Supplemental schedule of non-cash investing and financing activities: |            |            |
| Interest paid in cash   | \$ 6,006   | \$ 866     |
| Debt satisfied with stock   | \$ -       | \$ 206,000 |
| Reclassification of liability to equity for warrants issued           | \$ 805,300 | \$ -       |

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

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The accompanying unaudited financial statements 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-month periods ended December 31, 2003 and 2002 and are not necessarily indicative of the results that may be experienced for the fiscal year ending June 30, 2004.

These 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 financial statements should be read in conjunction with the Kronos Advanced Technologies, Inc. Form 10-KSB for the fiscal year ended June 30, 2003 filed on September 28, 2003 and Form 10-QSB for the quarter ended September 30, 2003 filed on November 14, 2003.

RECENT ACCOUNTING PRONOUNCEMENTS. In May 2003, the Financial Accounting Standards Board issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003 and, otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The effect of adopting SFAS No. 150 has been to reclassify approximately \$805,300 in Redeemable Warrants from a quasi-liability to the Shareholders' Deficit section of the balance sheet.

In December 2003, the Financial Accounting Standards Board revised SFAS No. 132, "Employers Disclosures about Pension and Other Postretirement Benefits." This statement revises employer's disclosures about pension plans and other postretirement benefit plans. It does not change the measurement or recognition of those plans as required by SFAS Nos. 87, 88 or 106. The revision of SFAS No. 132 is effective for financial statements with fiscal years ending after December 15, 2003. The Company believes that the adoption of the revised SFAS No. 132 will have no significant impact on its financial statements.

### NOTE 2 -- INCOME TAXES

The composition of deferred tax assets and the related tax effects at December 31, 2003 and June 30, 2003 are as follows:

|   | December 31, 2003<br>(Unaudited) | June 30, 2003 |
|---|----------------------------------|---------------|
|   | -----                            | -----         |
| Benefit from carryforward of capital and net operating losses | \$ 4,402,119                     | \$ 4,034,973  |
| Other temporary differences                                   | 156,740                          | 188,206       |
| Less:   |                                  |               |
| Valuation allowance   | (4,558,859)                      | (4,223,179)   |
| Net deferred tax asset  | \$ -                             | \$ -          |
|   | =====                            | =====         |

The other temporary differences shown above relate primarily to 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

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U.S. Federal statutory rate of 34% were applied to pre-tax loss is as follows:

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|  | December 31, 2003<br>(Unaudited) |                   | Amount   |
|--|----------------------------------|-------------------|----------|
|  | Amount                           | % of Pre-Tax Loss |          |
| Benefit for income tax at federal statutory rate | \$ 380,967                       | 34.0%             | \$ 941,7 |
| Benefit for income tax at state statutory rate   | 22,334                           | 2.0%              | 55,2     |
| Non-deductible expenses                          | (48,836)                         | (4.4)%            | 319,9    |
| Increase in valuation allowance                  | (354,465)                        | (31.6)%           | (1,316,9 |
|  | \$ -                             | 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, 2003, for federal income tax and alternative minimum tax reporting purposes, the Company has approximately \$9.7 million of unused Federal net operating losses, \$2.3 million of capital losses and \$8.6 million of unused State net operating losses available for carryforward to future years. The benefit from carryforward of such losses will expire in various years between 2006 and 2023 and could be subject to limitations if significant ownership changes occur in the Company.

### NOTE 3 - SEGMENTS OF BUSINESS

The Company operates principally in one segment of business: The Company licenses, manufactures and distributes air movement and purification devices utilizing the Kronos(TM) technology. All other segments have been disposed of or discontinued. For the six months ended December 31, 2003, the Company operated only in the U.S.

### NOTE 4 - EARNINGS PER SHARE

Weighted average shares outstanding used in the earnings per share calculation were 56,945,587 and 47,021,691 for the three months ended December 31, 2003 and 2002, respectively, and 55,459,617 and 45,774,213 for the six months ended December 31, 2003 and 2002, respectively.

As of December 31, 2003, there were outstanding options to purchase 11,040,260 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, 2002, there were outstanding options and warrants to purchase 7,818,675 and 2,300,000 shares, respectively, of the Company's common stock. These options have been excluded from the earnings per share calculation as their effect is anti-dilutive.

### NOTE 5 - NOTES PAYABLE

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The Company had the following notes payable obligations at December 31, and June 30, 2003:

|   | December 31, 2003<br>(Unaudited) | June 30, 2003 |
|---|----------------------------------|---------------|
|   | -----                            | -----         |
| Obligation to HoMedics (1)                            | \$ 2,400,000                     | \$ 2,400,000  |
| Obligations for purchase of intellectual property (2) | 115,000                          | 270,000       |
| Obligations under capital leases (3)                  | 62,720                           | 72,424        |
| Obligation to former director (4)                     | 62,430                           | 84,725        |
| Obligations to others (5)                             | 5,000                            | 35,000        |
|   | -----                            | -----         |
| Total Notes Payable                                   | \$ 2,645,150                     | \$ 2,862,149  |
| Current portions:                                     |                                  |               |
| Obligation to HoMedics                                | \$ 404,501                       | \$ -          |
| Obligations for purchase of intellectual property     | 115,000                          | 90,000        |
| Obligation to former director                         | 40,000                           | 40,000        |
| Obligations under capital leases                      | 23,362                           | 20,670        |
| Obligations to others                                 | 5,000                            | 35,000        |
|   | -----                            | -----         |
| Total current portion                                 | \$ 587,863                       | \$ 185,670    |
|   | -----                            | -----         |
| Total long term obligations net of current portion    | \$ 2,057,287                     | \$ 2,676,479  |
|   | =====                            | =====         |

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- (1) This is a 5 year note bearing interest at 6%. No payments due until the first anniversary date. Quarterly payments of principal and interest due thereafter.
- (2) This is a non-interest bearing obligation with quarterly payments of \$30,000 until paid in full.
- (3) See Note 6 - Capital Leases.
- (4) This note is to a former officer and director and bears interest at 12%. The note calls for quarterly payments of at least \$10,000 with the remaining amount, if any, due on March 31, 2004.
- (5) This is a non-interest bearing obligation with monthly payments of \$5,000 until paid in full in January 2004.

### NOTE 6 - CAPITAL LEASES

The Company entered into a capital lease for the purpose of purchasing equipment used in the research center. Certain Officers of the Company personally guaranteed the capital lease if the Company does not full fill its terms of the lease obligations. The leases are for 36 months and contain bargain purchase provisions so that the Company can purchase the equipment at the end of each lease. The following sets forth the minimum future lease payments and present values of the net minimum lease payments under these capital leases:

Minimum Future Lease Payments and  
Present Values of the Net Minimum Lease Payments



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|   |           |
|---|-----------|
| Period ended December 31,                   |           |
| 2004  | \$ 36,337 |
| 2005  | 36,337    |
| 2006  | 9,943     |
|   | -----     |
| Total minimum lease payments                | 82,617    |
| Less: Executory costs                       | -         |
|   | -----     |
| Net minimum lease payments                  | 82,617    |
| Less: Imputed interest                      | 19,897    |
|   | -----     |
| Present value of net minimum lease payments | \$ 62,720 |
|   | =====     |

Of the equipment that was purchased using capital leases, \$10,650 was capitalized and the remaining \$65,782 was expensed through research and development and cost of sales. In the three and six months ended December 31, 2003, the Company paid \$5,000 and \$9,703, respectively, in principal and \$4,085 and \$8,466, respectively, in interest on capital leases.

### NOTE 7 - CONSULTING AGREEMENTS

In October 2001, the Company entered into a 15-month consulting agreement with Joshua B. Scheinfeld and Steven G. Martin, principals of Fusion Capital, for consulting services with respect to operations, executive employment issues, employee staffing, strategy, capital structure and other matters as specified from time to time. As consideration for their services, the Company issued 360,000 shares of its common stock. In accordance with EITF 96-18, the measurement date was established as the contract date of October 1, 2001 as the share grant was non-forfeitable and fully vested on that date. The stock was valued on that date at \$0.28 a share (the closing price for the Company's common stock on the measurement date). The stock issuance has been recorded as a prepaid consulting fee and was amortized to Professional Fee Expense ratably over the 15-month term of the contract. During the three and six month periods ending December 31, 2002, the Company recognized professional services expenses of \$20,000 and \$40,000, respectively under this agreement. There were no expenses recorded under this agreement in the six months ended December 31, 2003.

Effective March 11, 2002, the Company entered into a new agreement with the Eagle Rock Group for a nearly one year period ending March 1, 2003. Pursuant to the agreement, the Company issued a note for the outstanding balance of \$120,000 due to The Eagle Rock Group, which has been paid in full. The Company granted Eagle Rock a ten-year warrant granting them the right to purchase 900,000 shares of our common stock. Two hundred and fifty thousand (250,000) warrant shares at an exercise price of \$0.42 and two hundred and fifty thousand (250,000) warrant shares at an exercise price of \$0.205 (the closing price of the Company's common stock on March 1, 2002) were earned over a 12-month period and four hundred thousand (400,000) warrant shares at an exercise price of \$0.145 were earned upon securing of our Licensing Agreement with HoMedics. These warrants are irrevocable and are fully vested. For the 400,000 warrants earned upon securing the HoMedics License Agreement, the measurement date is October 22, 2002 as the warrants became fully vested and non-forfeitable on the date. The value assigned to these 400,000 warrants is \$56,800 and was determined using the

Black-Scholes option valuation model. The \$56,800 was expensed in the period of the measurement date. For the other 500,000 warrants, the measurement date is March 1, 2002 as the warrants are fully vested and non-forfeitable on that date.

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The value assigned to these warrants is \$62,500 and was determined using the Black-Scholes option valuation model. The 500,000 warrants were for general consulting services for a 12 month period. The \$62,500 was expensed ratably over the term of the consulting contract. Under this contract, expenses of \$15,625 and \$88,050 were recorded for the three and six months ended December 31, 2002, respectively. There were no expenses recorded under this contract in the six months ended December 31, 2003.

On October 31, 2003, the Company entered into a 10-month consulting agreement with Joshua B. Scheinfeld and Steven G. Martin, principals of Fusion Capital, for consulting services with respect to operations, executive employment issues, employee staffing, strategy, capital structure and other matters as specified from time to time. As consideration for their services, the Company issued 360,000 shares of its common stock. In accordance with EITF 96-18, the measurement date was established as the contract date of October 31, 2003 as the share grant was non-forfeitable and fully vested on that date. The stock was valued on that date at \$0.22 a share (the closing price for the Company's common stock on the measurement date). The stock issuance has been recorded as a prepaid consulting fee and is being amortized to Professional Fee Expense ratably over the 10-month term of the contract. Under this contract, expenses of \$15,840 and \$15,840 were recorded for the three and six months ended December 31, 2003.

### NOTE 8 - REALIZATION OF ASSETS

The accompanying 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 quarter ended December 31, 2003. In addition, the Company has used, rather than provided cash in its operations. The Company is currently using its resources to raise capital necessary to complete research and development work, 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, to maintain present financing and to succeed in its future operations. The 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:

HoMedics Licensing Agreement. In October 2002, Kronos Air Technologies, Inc., and HoMedics USA, Inc. executed a multiyear, multi-million-dollar Licensing Agreement to bring Kronos(TM) proprietary technology to the consumer. The agreement provides for exclusive North American, Australian and New Zealand retail distribution rights for next generation consumer air movement and purification products based on the patented Kronos(TM) technology. In November 2002, Kronos and HoMedics executed a Development Agreement to provide Kronos with the financial resources necessary to complete commercialization of the initial Kronos(TM)-based consumer product line. Kronos is working with HoMedics' engineers, designers, manufacturers, and marketing and sales personnel to complete the initial product line for sales and distribution. HoMedics is focused on product design and features, completion of manufacturing tooling and assembly line processes, and product packaging. Kronos is focused on completion of the technical hardware and related power supplies for each of the products in

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the air purification product line, as well as on developing product features and benefits unique to this initial consumer product line. Together Kronos and HoMedics are focused on finalizing the technology and the production process to allow for cost effective mass production. While HoMedics is managing production of the finished product, Kronos is managing the production of our proprietary power supply and related circuitry.

The initial term of the agreement is three and one half years with the option to extend the agreement for six additional years. Kronos will be compensated through an initial royalty payment and ongoing quarterly royalty payments based on a percentage of sales. HoMedics will pay minimum royalty payments of at least \$2 million during the initial term and on-going royalty payments to extend the agreement. Kronos will retain full rights to all of its intellectual property.

US Navy SBIR. In November 2002, Kronos was awarded by the U. S. Navy a Small Business Innovation Research Phase II contract. The Phase II contract (commercialization phase) is an extension of the Phase I and the Phase I Option work that began in 2001. It is intended that the Kronos(TM) devices being developed under this contract will be embedded in existing HVAC systems in order to move air more efficiently than traditional, fan-based technology. During

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Phase II, Kronos shall develop, produce and install a set of fully controlled devices that represent a "cell" of an advanced distributive air management system with medium capacity airflow in a U.S. Navy unique environment. The "cell" will be designed to be easily adjustable to a variety of parameters such as duct size, airflow requirements, and air quality. As of December 31, 2003, U. S. Navy had provided Kronos with \$246,000 in funding for this effort under the Phase II contract.

HoMedics Provided Debt Financing. In May 2003, Kronos entered into an agreement with HoMedics, Inc. for \$3.5 million in financing, including \$3.4 million in secured debt financing and \$100,000 for the purchase of warrants. \$2.5 million was paid to Kronos upon execution of the agreement and \$1.0 million will be paid upon the start of production as defined in the Licensing Agreement for the Kronos(TM)-based air purification product line to be marketed and distributed by HoMedics. In conjunction with securing this financing, Kronos and HoMedics agreed to negotiate the expansion of our relationship into additional Kronos(TM)-based stand-alone consumer products, including fans, heaters, humidifiers and dehumidifiers, as well as geographic expansion into Europe and Asia.

US Army SBIR. On November 1, 2003, Kronos was awarded by the U.S. Army a Small Business Innovation Research Phase II contract. This is a one-year contract to produce a prototype dehumidification device utilizing Kronos (TM) technology. If the Company is successful in producing a working prototype, an additional one-year contract will be awarded for further development work. The initial contract is for \$369,000. The proceeds from this contract will be used to pay the Company's expenses associated with the project.

### NOTE 9 - COMMITMENTS AND CONTINGENCIES

In May 2003, Kronos entered into an agreement with a strategic customer, HoMedics, Inc., for \$3.5 million in financing, including \$3.4 million in secured debt financing and \$100,000 for the purchase of warrants. \$2.5 million was paid to Kronos upon execution of the agreement and \$1.0 million will be paid upon the start of production as defined in the Licensing Agreement for the Kronos-based air purification product line to be marketed and distributed by HoMedics. There is a risk that we will not be successful in achieving production as defined in

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the Licensing Agreement. In exchange for providing \$3.4 million in debt financing and \$100,000, Kronos provided HoMedics with two warrants: (i) 6.7 million warrants (which equated to 10% of the then fully diluted shares) fully vested at the time of funding and (ii) 6.7 million warrants (which equated to 10% of the then fully diluted shares) which will vest only if (1) Kronos does not prepay the entire amount of principal and interest due under the Notes by November 8, 2005; (2) Kronos is in default under any of the Investment Documents, or (3) Kronos does not earn, at any time after the date of this Agreement but prior to November 8, 2005, revenues in an aggregate amount equal to or greater than \$3.5 million. The exercise price was set at the market price at the time of closing (\$0.10). HoMedics may not be diluted below 7.5% for the first warrant (15% for both warrants) for any funds raised at less than \$0.20 per share, excluding options or shares issued to management, directors, and consultants in the normal course of business. There are no anti-dilution measures for funds raised at greater than \$0.20 per share.

### EMPLOYMENT AGREEMENTS

The Company entered into an Employment agreement with Daniel Dwight, our President and Chief Executive Officer, effective as of November 15, 2001. The initial term of the Employment Agreement is for 2 years and will automatically renew for successive 1 year terms unless written notice within 3 months of the end of the initial term or any subsequent renewal term is received by either party. The Board of Directors renewed the Employment Agreement on August 13, 2003. The Employment Agreement provides for base cash compensation of \$180,000 per year and eligibility for annual incentive bonus compensation in an amount equal to annual salary based on the achievement of certain bonus objectives.

The Company entered into an Employment agreement with Richard Tusing, our Chief Operating Officer, effective as of January 1, 2003. The initial term of the Employment Agreement is for 2 years and will automatically renew for successive 1 year terms unless written notice within 3 months of the end of the initial term or any subsequent renewal term is received by either party. The Employment Agreement provides for base cash compensation of \$160,000 per year.

### NOTE 10 - SUBSEQUENT EVENTS

None

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## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### INTRODUCTORY STATEMENTS

#### FORWARD-LOOKING STATEMENTS AND ASSOCIATED RISKS

This filing contains forward-looking statements, including statements regarding, among other things: (a) the growth strategies of Kronos Advanced Technologies (the "Company" or "Kronos"); (b) anticipated trends in our Company's industry; (c) our Company's future financing plans; and (d) our Company's ability to obtain financing and continue operations. In addition, when used in this filing, the words "believes," "anticipates," "intends," "in anticipation of," and similar words are intended to identify certain forward-looking statements. These forward-looking statements are based largely on our Company's expectations and are subject to a number of risks and uncertainties, many of which are beyond our Company's control. Actual results could differ materially from these forward-looking statements as a result of changes in trends in the economy and

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our Company's industry, reductions in the availability of financing and other factors. In light of these risks and uncertainties, there can be no assurance that the forward-looking statements contained in this filing will in fact occur. Our Company does not undertake any obligation to publicly release the results of any revision to these forward-looking statements that may be made to reflect any future events or circumstances.

### GENERAL

Kronos Advanced Technologies, Inc. is a high technology industrial company focused on developing, marketing and selling products using the Company's proprietary air movement and purification technology. Kronos is pursuing commercialization of its patented technology in a limited number of markets; and if we are successful, we intend to enter additional markets in the future. To date, our ability to execute our strategy has been restricted by our limited amount of capital.

### Technology Description and Benefits

The Kronos(TM) technology combines high voltage electronics and electrodes. By combining these technologies, a Kronos(TM)-based device can both move and clean air without any moving parts. Kronos(TM) devices are versatile, energy- and cost-efficient and capable of multiple design forms. As a result, Kronos(TM) devices have the immediate potential to be used as a standalone product or to replace a range of heating, ventilation and air conditioning ("HVAC") products for residential usage to high efficiency particulate air ("HEPA") filtration systems for operating and manufacturing clean rooms.

The proprietary Kronos(TM) technology involves the application of high voltage management across paired electrical grids to create an ion exchange that moves and purifies air. Kronos(TM) technology has numerous valuable characteristics. It moves air and gases at high velocities while removing odors, smoke and particulates and killing pathogens, including bacteria and mold. The technology is cost-effective and is more energy efficient than current alternative fan and filter (including HEPA filter and ultraviolet light based) technologies. To date, no commercial products using the Kronos(TM) technology have been sold.

A number of the scientific claims of the Kronos(TM) technology have been tested by the U. S. government and a few multi-national companies, including the U. S. Department of Energy, the U. S. Department of Defense, General Dynamics, Underwriters Laboratory, and Intel. Independent laboratory testing has verified the purification capability of the Kronos(TM) technology. Tests conducted at MicroTest Laboratories and at the New Hampshire Materials Laboratory demonstrated HEPA Clean Room Class 1000 quality particulate reduction and up to 95% reduction of hazardous gases (in one air pass through the Kronos(TM) system), including numerous contaminants found in cigarette smoke.

### Market Segmentation

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

Kronos' initial focus is on the first three of these market segments which are described in more detail below. Kronos is currently developing products for the air movement and purification, air purification for unique spaces, and

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specialized military through customer contracts which were executed over the past twelve months. These contracts are described in more detail in the Technology Application and Product Development section of this filing.

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- o Air Movement and Purification. Indoor air pollution, including "sick building syndrome" and "building related illness," is primarily caused by inadequate ventilation, chemical contaminants from indoor and outdoor sources and biological contaminants. The addressable air movement and purification segment is made up of four principal applications: (1) health care, (2) hospitality, (3) commercial and (4) residential. Kronos is seeking to leverage the product development and funding resources of HoMedics, Inc., Kronos' strategic partner for consumer-based residential applications, to develop standalone products for other air movement and purification applications.
- o Air Purification for Unique Spaces. Electronics, semiconductor, pharmaceutical, aerospace, medical and many other producers depend on cleanroom 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 product. Other potential applications for the Kronos(TM) technology include closed environments such as aircraft, cruise ships and other transportation modes that require people to breathe contaminated, re-circulated air for extended periods. Kronos is building on its product development effort with its strategic partner in the business jet market to serve other closed environment applications.
- o Specialized Military. Military personnel face the worst of all possible worlds: indoor air pollution, often in very confined spaces for extended periods, combined with the threat of biological warfare, nuclear fallout, and other foreign elements. The military market segment offers Kronos a unique opportunity to leverage the technical and funding resources of the U. S. military to expand Kronos' ability to develop and produce Kronos(TM)-based air movers and purifiers for applications that require these products to be embedded into ventilation systems to address the needs of military personnel.

### 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(TM) 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(TM) device into a wall outlet to obtain air filtration for their home, office or hotel room. Embedded applications of the Kronos(TM) 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.

#### Standalone Platform

- o HoMedics Contract. In October 2002, Kronos Air Technologies, Inc., and HoMedics USA, Inc. executed a Licensing Agreement granting HoMedics certain rights with respect to the distribution of the Kronos(TM) proprietary technology to the consumer. The agreement provides for exclusive North American, Australian and New Zealand retail distribution rights for next generation consumer air movement and

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purification products based on the patented Kronos(TM) technology. In November 2002, Kronos and HoMedics executed a Development Agreement to provide Kronos with the financial resources believed necessary to complete commercialization of the initial Kronos(TM)-based consumer product line. Kronos is working with HoMedics' engineers, designers, manufacturers, and marketing and sales personnel to complete an initial product line for sales and distribution. HoMedics is focused on product design and features, completion of manufacturing tooling and assembly line processes, and product packaging, including prominent display of the "Kronos" brand. Kronos is focused on completion of the technical hardware and related power supplies for each of the products in the air purification product line, as well as developing product features and benefits unique to this initial consumer product line. Together Kronos and HoMedics are focused on finalizing the technology and the production process to allow for cost effective mass production, including testing and evaluating pre-production devices that will be placed in commercial production. While HoMedics is managing production of the finished product, Kronos is managing the production of our proprietary power supply and related circuitry.

The initial term of the agreement is three and one half years with the option to extend the Licensing Agreement for six additional years. Kronos was compensated through an initial royalty payment and will receive ongoing quarterly royalty payments based on a percentage of sales. HoMedics will pay minimum royalty payments of at least \$2 million during the initial three and a half year term and on-going royalty payments to extend the agreement. Kronos will retain the rights to all of its intellectual property.

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HoMedics commitment includes funding a marketing and advertising campaign to promote the Kronos(TM)-based product line. The products will be distributed by HoMedics. HoMedics currently distributes their products through major domestic retailers, including Wal-Mart, Home Depot, Sears, Bed Bath & Beyond, and Linens 'N Things.

In May 2003, Kronos entered into an agreement with HoMedics, Inc. for \$3.5 million in financing, including \$3.4 million in secured debt financing and \$100,000 for the purchase of warrants. \$2.5 million was paid to Kronos upon execution of the agreement and \$1.0 million will be paid upon the start of production as defined in the Licensing Agreement for the Kronos(TM)-based air purification product line to be marketed and distributed by HoMedics. A provision of the agreement gives HoMedics a security interest in the assets of Kronos, including its technology. In conjunction with securing this financing, Kronos and HoMedics agreed to negotiate the expansion of our relationship into additional Kronos(TM)-based stand-alone consumer products, including fans, heaters, humidifiers and dehumidifiers, as well as geographic expansion into Europe and Asia.

Kronos is seeking to leverage its consumer product development work with HoMedics to develop and produce our own commercial line of standalone air purifiers. This commercial line of Kronos(TM)-based air purifiers would attempt to address the specific air quality issues, including odors, bacteria and viruses, found in most nursing home and assisted living, healthcare and other commercial facilities.

### Embedded Platform

- o U. S. Navy SBIR Contracts. The U. S. Department of Defense and

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Department of Energy have provided Kronos with various grants and contracts to develop, test and evaluate the Kronos(TM) technology for embedded applications. Kronos has developed several commercial and industrial applications, including the retrofit of berthing fan systems and embedded air movement systems for U. S. Navy Aegis Class destroyers.

In November 2002, the U. S. Navy awarded Kronos a Small Business Innovation Research Phase II contract worth \$580,000, plus an option of \$145,000. The Phase II contract (commercialization phase) is an extension of the Phase I and the Phase I Option work that began in 2001. It is intended that the Kronos(TM) devices being developed under this contract will be embedded in existing HVAC systems in order to move air more efficiently than traditional, fan-based technology.

During Phase II, Kronos will attempt to develop, produce and install a set of fully controlled devices that represent a "cell" of an advanced distributive air management system with medium capacity airflow in a U. S. Navy unique environment. The "cell" will be designed to be easily adjustable to a variety of parameters such as duct size, airflow requirements, and air quality. The goal of this development work is to significantly reduce or replace altogether the current HVAC air handling systems on naval ships. During the initial twelve months of the contract, Kronos has designed a new generation power supply, improved the efficiency of the core technology to allow for increased air movement and filtration, and initiated selection with the U. S. Navy of the specifications for the commercial products to be built under the Phase II contract. As of December 31, 2003, the U. S. Navy had provided Kronos with \$246,000 in funding for this effort under the Phase II.

As part of its air management system, Kronos intends to develop and test an air filtration mechanism capable of performing to HEPA quality standards. We believe that Kronos(TM) devices could replace current HEPA filters with a permanent, easily cleaned, low-cost solution. The U. S. Navy unique environment includes shock exposure, vibration, Electromagnetic Interference/Compatibility (EMI/EMC), and salt spray. Kronos(TM) devices will be built and tested to meet specific Navy standards. Testing shall include assessments for system performance, including control techniques, noise levels, and acquisition and lifecycle costs.

We believe that during the option portion of the contract, Kronos(TM) technology's ability to kill bacteria and other pathogens will be confirmed and expanded to a wide range of pathogens for space disinfection and bio-terrorist attacks. We believe the Kronos(TM) technology can kill all or most airborne pathogens regardless of their nature, genetic structure, robustness, or method of delivery.

Kronos has begun the process for obtaining Phase III (production phase) support for the Kronos(TM)-based advanced distributive air management system being developed under Phase II. Phase III contracts may be awarded prior to completion of Phase II contract work. Kronos is working directly with Dawnbreaker, a U. S. Government entity established for the purpose of supporting companies seeking Phase III contracts.

- o U. S. Army SBIR Contracts. In August 2003, Kronos was awarded the option on its U. S. Army Small Business Innovation Research Phase I contract bringing the value of the Phase I contract award to \$120,000.



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On November 7, 2003, the U.S. Army awarded Kronos the Small Business Innovation Research Phase II contract. The first year of the contract is worth \$369,000 with an Army option on the second year worth \$360,000. The contract is to develop Kronos' proprietary Electrostatic Dehumidification Technology ("EDT"). Kronos initiated work under the Phase I option and the Phase II contracts in October and December 2003, respectively.

The objective of the Phase II effort is to implement and optimize dehumidification via Kronos electrostatic field technology. The objective is to be accomplished by: (1) prototype design and manufacturing, (2) prototype testing in the laboratory environment and field demonstration, (3) analytical and numerical modeling of Kronos' EDT process, and (4) project documentation and reporting including interim and final reports. We anticipate the Kronos(TM) devices manufactured under this contract will further demonstrate the versatility of the Kronos(TM) technology to meet airflow, system pressure and reduced humidity requirements for HVAC systems. In December 2001, Kronos was awarded the Phase I contract. Phase I of the contract was worth \$70,000 in funding to investigate and analyze the feasibility of the Kronos(TM) technology to reduce humidity in HVAC systems. Dehumidification is essential to making HVAC systems more energy efficient.

Kronos is seeking to leverage its military application development work with the U. S. Navy and U. S. Army to develop and produce air handlers and purifiers for commercial and industrial facilities. A future potential commercial line of Kronos(TM)-based air handlers and purifiers would attempt to address the specific air quality issues, including bacteria and other germs, found in large enclosed spaces such as office buildings and multi-dwelling residential complexes, while providing more efficient air movement.

- o Business Jet Manufacturer. In January 2003, Kronos extended its work into the transportation industry by signing a Development and Acquisition Agreement with a premier business jet manufacturer. The Agreement was the direct result of initial prototype development work performed by the Kronos Research Team with input from the customer in 2002. The Kronos(TM) devices being designed and manufactured under this contract will need to meet all FAA safety standards, including environmental, flammability and electromagnetic interference (EMI). The Company is working on completing product design and development based on the customer's specific product application requirements.

Kronos is seeking to leverage its business jet application development work to develop and produce air handlers and purifiers for the commercial aviation and automotive markets. A future potential commercial line of Kronos(TM)-based air handlers and purifiers would attempt to address the specific air quality issues, including exhaust and viruses, found in enclosed spaces occupied by multiple people for extended periods of time, while providing more efficient air movement within unique space constraints.

### Patents and Intellectual Property

In December 2003, Kronos received formal notification from the United States Patent and Trademark Office indicating that its application entitled "Method of and Apparatus for Electrostatic Fluid Acceleration Control of a Fluid Flow" has been examined and allowed for issuance as a U. S. patent (#6,664,741). The patent provides protection for key aspects of Kronos' technology until late in 2020.

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In January 2003, Kronos received formal notification from the United States Patent and Trademark Office indicating that its application entitled "Electrostatic Fluid Accelerator" has been examined and allowed for issuance as a U. S. patent (#6,504,308). The patent provides protection for key aspects of Kronos' technology until late in 2019.

In addition to the "Electrostatic Fluid Accelerator" and "Method of and Apparatus for Electrostatic Fluid Acceleration Control of a Fluid Flow" patents, 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. There are a number of corresponding patent applications, which have been filed and are pending outside of the United States.

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### 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 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 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

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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 101 ("SAB 101"). 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 balance sheet. For uncompleted contracts where billings exceed costs and 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.

### RESULTS OF OPERATIONS

The Company's net loss from continuing operations for the three months ended December 31, 2003 increased by 21% to \$570,000, compared with a net loss of \$473,000 for the corresponding period of the prior year. The increase in the net loss was primarily the result of an decrease in gross profit (\$138,000) and other income (\$86,000) and an increase in interest expense (\$94,000), offset by a decrease in selling, general and administrative expenses (\$221,000). The Company's net loss from continuing operations for the six months ended December 31, 2003 increased by 5% to \$1,120,000, compared with a net loss of \$1,064,000 for the corresponding period of the prior year. The increase in the net loss was primarily the result of an increase in interest expense (\$228,000) and a decrease in gross profit (\$107,000) and other income (\$86,000), offset by a decrease in selling, general and administrative expenses (\$366,000).

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REVENUE. Revenues are generated through sales of Kronos(TM) devices, and fees earned from licensing the Kronos(TM) technology and providing technical services to our customers at Kronos Air Technologies, Inc. Revenue for the three months ended December 31, 2003 was \$112,000. These revenues were primarily from our HoMedics, U. S. Navy SBIR Phase II and U. S. Army SBIR Phase I Option contracts. Revenue of \$210,000 recorded during the corresponding period of the prior year was primarily from a licensing fee earned from our HoMedics contract, as well as revenue earned from our U. S. Army and U. S. Navy SBIR Phase I contracts. Revenue for the six months ended December 31, 2003 was \$242,000. These revenues were primarily from our HoMedics, U. S. Navy SBIR Phase II and U. S. Army SBIR Phase I and Phase I Option contracts. Revenue of \$318,000 recorded during the corresponding period of the prior year was primarily from our HoMedics, U. S. Navy and U. S. Army SBIR contracts.

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**COST OF SALES.** Cost of sales for the three and six months ended December 31, 2003 were \$73,000 and \$156,000, compared to \$33,000 and \$125,000 for the corresponding periods of the prior year, respectively. Cost of sales in the current year was primarily development costs associated with our HoMedics, U. S. Navy SBIR and U. S. Army SBIR contracts. Prior year cost of sales related to revenue from U. S. Army and U. S. Navy SBIR Phase I contracts. There was no cost of sales associated with the licensing fees earned from our HoMedics license agreement during the corresponding periods of the prior year.

**GROSS PROFIT.** Gross profit for the three and six months ended December 31, 2003 was \$38,000 and \$86,000, compared to \$176,000 and \$193,000 for the corresponding periods of the prior year, respectively. The decreases were primarily the result of higher revenue in the corresponding periods of the prior year, including an initial licensing fee earned from the HoMedics contract.

**SELLING, GENERAL AND ADMINISTRATIVE EXPENSES.** Selling, general and administrative expenses for the three months ended December 31, 2003 decreased 31% to \$502,000 compared to \$723,000 for the corresponding period of the prior year. This \$221,000 decrease was primarily the result of a decrease in professional services (\$329,000) offset by an increase in compensation and benefits (\$79,000). The decrease in professional services was the result of a reduction in business consulting (\$193,000), and legal and auditing (\$137,000) expenses. The reduction in business consulting included the benefit to the Company from converting our Chief Operating Officer from a consulting agreement to a full time employment contract. Selling, general and administrative expenses for the six months ended December 31, 2003 decreased 28% to \$932,000 compared to \$1,297,000 for the corresponding period of the prior year. This \$365,000 decrease was primarily the result of a decrease in professional services (\$570,000) offset by an increase in compensation and benefits (\$147,000). The decrease in professional services was the result of a reduction in business consulting (\$346,000), and legal and auditing (\$224,000) expenses.

**OTHER INCOME.** Other income for the three and six months ended December 31, 2003 was \$22,000 and represented consideration earned from the assignment of the Company's stock repurchase rights to Fusion Capital who made a partial repurchase of the Company's stock used in May 2003 to acquire the remaining license rights to the Kronos(TM) technology not included in the original acquisition of Kronos Air Technologies, Inc. Other income for the three and six months ended December 31, 2002 was \$108,000 and represented primarily the gain on the payment of a note payable balance with stock.

**INTEREST EXPENSE.** Interest expenses for the three and six months ended December 31, 2003 increased to \$128,000 and \$296,000 compared to \$34,000 and \$68,000 for the corresponding periods of the prior year. The \$94,000 and \$228,000 increases, respectively, were primarily the result of the increase in accrued interest expenses from Company's debt financing obligation to HoMedics and from the Company's accounts payable obligation to Kronos' directors and officers.

### CONSOLIDATED BALANCE SHEET AS OF DECEMBER 31, 2003

Our total assets at December 31, 2003 and June 30, 2003 were \$2.8 million and \$3.2 million, respectively. Total assets at December 31, 2003 were comprised primarily of \$2.4 million of patents/intellectual property and \$0.2 million of cash. Total assets at June 30, 2003 were comprised primarily of \$2.5 million of patents/intellectual property and \$0.6 million of cash. Total current assets at December 31, 2003 and June 30, 2003 were \$0.3 million and \$0.7 million, respectively, while total current liabilities for those same periods were \$2.1 million and \$1.9 million, respectively, creating a working capital deficit of \$1.8 million and \$1.2 million at each respective period end. This working capital deficit is primarily due to accrued expenses for compensation, management consulting and other professional services and the current portion of notes payable. Shareholders' deficit as of December 31, 2003 and June 30, 2003

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were \$(0.7) million and \$(1.2) million, respectively, representing a decrease of \$0.5 million. The decrease in shareholders' deficit is primarily the result of a reclassification of \$0.8 million in redeemable warrants to equity based on FAS 150 and the sale and issuance of \$0.8 million of common stock, partially offset through incurring a \$1.1 million loss from continuing operations for the six months ended December 31, 2003.

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### LIQUIDITY AND CAPITAL RESOURCES

Net cash flow used on operating activities was \$1.0 million for the six month period ended December 31, 2003. We were able to satisfy our cash requirements for this period through funding provided by HoMedics under the terms of our secured financing from them, under the terms of our common stock purchase agreement with Fusion pursuant to which the Company may sell shares of its common stock and our revenue generating customer contracts with HoMedics, U. S. Navy and U. S. Army.

On May 9, 2003, we closed on a \$3.5 million secured financing from a strategic customer, HoMedics, Inc. \$2.5 million was advanced to Kronos upon execution of the agreement and \$1.0 million will be advanced upon the start of production for the Kronos-based air purification product line to be marketed and distributed by HoMedics.

Kronos SBIR contracts with the U. S. Military, including the U. S. Army Phase I Option and Phase II and the U. S. Navy Phase II contracts, are potentially worth, if all options are exercised, up to \$1.5 million in product development and testing support for Kronos Air Technologies. In November 2002, Kronos Air Technologies was awarded by the U. S. Navy for a Small Business Innovation Research Phase II contract worth \$580,000, plus an option of \$150,000. As of December 31, 2003, Kronos has received \$246,000 in funding under the U. S. Navy SBIR Phase II contract. On November 7, 2003, the U. S. Army awarded Kronos a Small Business Innovation Research Phase II contract. The first year of the contract is worth \$369,000 with an Army option on the second year worth \$360,000. In August 2003, Kronos Air Technologies obtained notice from the U. S. Army for the option of the SBIR Phase I contract worth \$50,000. To earn these future amounts, we will have to complete the required work.

On June 19, 2001, we entered into a common stock purchase agreement with Fusion Capital. Pursuant to this agreement, we have sold approximately 6 million shares of our common stock and have received \$1.3 million.

On August 12, 2002, we terminated our common stock purchase agreement dated June 19, 2001 and entered into a new common stock purchase agreement with Fusion Capital. Pursuant to the 2002 common stock purchase agreement, Fusion Capital has agreed to purchase on each trading day during the term of the agreement, \$10,000 of our common stock or an aggregate of \$6.0 million. The \$6.0 million of our common stock can be purchased over a 30-month period, subject to a six-month extension or earlier termination at our sole discretion and subject to certain events. The purchase price of the shares of common stock will be equal to a price based upon the future market price of our common stock without any fixed discount to the then-current market price. Fusion Capital is obligated to purchase shares under the agreement as long as the share price exceeds a floor of \$0.10. However, there can be no assurance of how much cash we will receive, if any, under the common stock purchase agreement with Fusion Capital. Pursuant to this agreement, we have sold approximately 9 million shares of our common stock and have received \$1.3 million.

We estimate that achievement of our business plan and the payment of interest and principal on the Company's debt will require substantial additional funding. We anticipate that the source of funding will be obtained pursuant to the senior

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debt funding from HoMedics, Fusion Capital and/or the sale of additional equity in our Company, cash flow generated from government grants and contracts, which includes funding from the Small Business Innovation Research contracts sponsored by the U. S. Navy and Army awarded to Kronos Air Technologies, and cash flow generated from customer revenue. Pursuant to discussions with the companies that we believe will license our technology, we anticipate generating cash flow in our 2004 fiscal year from advance funding from these companies for production development work. There are no assurances that these sources of funding will be adequate to meet our cash flow needs.

### GOING CONCERN OPINION

Our independent auditors have included an explanatory paragraph to their audit opinions issued in connection with our 2003 and 2002 financial statements that states 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 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, manufacture 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.

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### 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 have a limited operating history with significant losses and expect losses to 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 operating loss of \$1.1 million for the six months ended December 31, 2003. We have incurred net losses from continuing operations of \$2.8 million for the fiscal years ended June 30, 2003. As a result, at December 31, 2003 and June 30, 2003, we had an accumulated deficit of \$18.6 million and \$17.5 million, 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 secured debt. We expect that our revenues and cash flows from operations may not be sufficient to sustain our operations for the foreseeable future. Our profitability will require the successful commercialization of our Kronos(TM) technologies. No assurances can be given that we will be able to successfully commercialize our Kronos(TM) technologies or that we will ever be profitable.

We will require significant additional financing to sustain our operations and with it we will not be able to continue operations.

At December 31, 2003 and June 30, 2003, we had a working capital deficit of \$1.8 million and \$1.2 million, respectively. The independent auditor's report for the year ended June 30, 2003, includes an explanatory paragraph to their audit

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opinion stating that our recurring losses from operations and working capital deficiency raise substantial doubt about our ability to continue as a going concern. For the six months ended December 31, 2003 and for the fiscal year ended June 30, 2003, we had an operating cash flow deficit of \$1.0 million and \$2.0 million, respectively. We currently do not have sufficient financial resources to fund our operations or pay certain existing obligations or those of our subsidiary. Therefore, we need substantial additional funds to continue these operations and pay certain existing obligations.

If obtaining sufficient financing from the U. S. Navy, U. S. Army, HoMedics and /or Fusion Capital were to be unavailable and if we are unable to commercialize and sell the products or technologies, we will need to secure another source of funding in order to satisfy our working capital needs. Even if we are able to access the funds available under the, U. S. Navy and U.S Army SBIR contracts, HoMedics senior debt agreement and / or the Fusion common stock purchase agreement, we may still need additional capital to fully implement our business, operating and development plans. At December 31 and June 30, 2003, we had a cash balance of \$178,000 and \$641,000, respectively. Should the financing we require to sustain our working capital needs be unavailable, or prohibitively expensive when we require it, we would be forced to curtail our business operations.

Existing shareholders will experience significant dilution from our sale of shares under the common stock purchase agreement with Fusion Capital and any other equity financing.

The sale of shares pursuant to our agreement with Fusion Capital, the exercise of HoMedics stock 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 addition, the lower our stock price is, the more shares of common stock we will have to issue under the common stock purchase agreement with Fusion Capital in order to draw down the full amount. If our stock price is lower, then our existing stockholders would experience greater dilution. We cannot predict the actual number of shares of common stock that will be issued pursuant to the agreement with Fusion Capital or any other future equity financing transaction, in part, because the purchase price of the shares will fluctuate based on prevailing market conditions and we do not know the exact amount of funds we will need.

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Competition in the market for air movement and purification devices may result in the failure of the Kronos(TM) 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 substantially 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(TM) products do not favorably compete with the products sold by our competitors, we would be forced to curtail 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

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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.

In December 2003, Kronos received formal notification from the United States Patent and Trademark Office indicating that its application entitled "Method of and Apparatus for Electrostatic Fluid Acceleration Control of a Fluid Flow" has been examined and allowed for issuance as a U. S. patent (#6,664,741). The patent provides protection for key aspects of Kronos' technology until late in 2020. In January 2003, Kronos received formal notification from the United States Patent and Trademark Office indicating that its application entitled "Electrostatic Fluid Accelerator" had been examined and allowed for issuance as a U. S. patent (#6,504,308). The patent will provide protection for key aspects of Kronos' technology until late in 2019. We have additional U. S. and foreign patent applications pending. 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.

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

Our net intangible assets of approximately \$2.4 million as of December 31, 2003 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(TM) technology not included in the original acquisition of Kronos Air Technologies, Inc. in May 2003. Intangible assets comprise 88% of our total assets as of December 31, 2003. 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(TM) technology and Kronos Air Technologies Chief Technology Officer, or the ability to create a customer base for the sale or licensing of the Kronos(TM) technology. 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.

Our common stock is deemed to be "Penny Stock," subject to special requirement 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:

- o With a price of less than \$5.00 per share;
- o That are not traded on a "recognized" national exchange;



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- o Whose prices are not quoted on the Nasdaq automated quotation system (Nasdaq listed stock must still have a price of not less than \$5.00 per share); or

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- o In issuers with net tangible assets less than \$2.0 million (if the issuer has been in continuous operation for at least three years) or \$5.0 million (if in continuous operation for less than three years), or with average revenues of less than \$6.0 million 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 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 development personnel are believed to be an 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(TM) 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. Within 90 days prior to the filing date of this report, our Company carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. This evaluation was done under the supervision and with the participation of our Company's President and Chief Financial Officer. Based upon that evaluation, they concluded that our Company's disclosure controls and procedures are effective in gathering, analyzing and disclosing information needed to satisfy our Company's disclosure obligations under the Exchange Act.

Changes in Internal Controls. There were no significant changes in our Company's internal controls or in other factors that could significantly affect those controls since the most recent evaluation of such controls.

## PART II

### ITEM 1. LEGAL PROCEEDINGS

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None.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

There were no sales of unregistered securities of the Company.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

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ITEM 5. 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 on Form S-1 filed on August 7, 2001   |
| 3.2         | Bylaws  | Incorporated by reference to Exhibit 3.2 to the Registration Statement on Form S-1 filed on August 7, 2001   |
| 4.1         | 2001 Stock Option Plan  | Incorporated by reference to Exhibit 4.1 to Registrant's Form 10-Q for the quarterly period ended March 31, 2002 filed on May 15, 2002                 |
| 5.1         | Opinion re: Legality  | Incorporated by reference to Exhibit 5.1 to Amendment No. 1 to Form S-1 filed on October 19, 2001  |
| 10.1        | Employment Agreement, dated April 16, 1999, by and between TSET, Inc. and Jeffrey D. Wilson | Incorporated by reference to Exhibit 10.1 to the Registration Statement on Form S-1 filed on August 7, 2001  |

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|       |  |  |
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| 10.2  | Deal Outline, dated December 9, 1999, by and between TSET, Inc. and Atomic Soccer, USA, Ltd.   | Incorporated by reference to Exhibit 10.2 to the Registration Statement on Form S-1 filed on August 7, 2001  |
| 10.3  | Letter of Intent, dated December 27, 1999, by and between TSET, Inc. and Electron Wind Technologies, Inc.  | Incorporated by reference to Exhibit 10.3 to the Registration Statement on Form S-1 filed on August 7, 2001  |
| 10.17 | Shareholders Agreement, dated September 12, 2000, by and among TSET, Inc., Bryan Holbrook and EdgeAudio.com, Inc.  | Incorporated by reference to Exhibit 10.17 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.18 | Amendment to Agreement and Plan of Reorganization dated September 12, 2000, by and among TSET, Inc., EdgeAudio.com, Inc., LYNK Enterprises, Inc., Robert Lightman, J. David Hogan, Eric Alexander and Eterna Internacional, S.A. de C.V. | Incorporated by reference to Exhibit 10.18 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.19 | Agreement Regarding Sale of Preferred Stock, dated November 1, 2000, by and between EdgeAudio.com, Inc. and Bryan Holbrook   | Incorporated by reference to Exhibit 10.19 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 21    |  |  |
| 10.20 | Amendment to Subcontract, dated December 14, 2000, by and between Bath Iron Works and High Voltage Integrated  | Incorporated by reference to Exhibit 10.20 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.21 | Consulting Agreement, dated January 1, 2001, by and between TSET, Inc. and Dwight, Tusing & Associates   | Incorporated by reference to Exhibit 10.21 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.22 | Employment Agreement, dated March 18, 2001, by and between TSET, Inc. and Alex Chriss  | Incorporated by reference to Exhibit 10.22 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.23 | Stock Option Agreement, dated April 9, 2001, by and between TSET, Inc. and Jeffrey D. Wilson   | Incorporated by reference to Exhibit 10.23 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.24 | Stock Option Agreement, dated April 9, 2001, by and between TSET, Inc. and Jeffrey D. Wilson   | Incorporated by reference to Exhibit 10.24 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.25 | Stock Option Agreement, dated April 9, 2001, by and between TSET, Inc. and Daniel R. Dwight  | Incorporated by reference to Exhibit 10.25 to the Registration Statement on Form S-1 filed on August 7, 2001 |

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| 10.26 | Stock Option Agreement, dated April 9, 2001, by and between TSET, Inc. and Richard F. Tusing                             | Incorporated by reference to Exhibit 10.26 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.27 | Stock Option Agreement, dated April 9, 2001, by and between TSET, Inc. and Charles D. Strang                             | Incorporated by reference to Exhibit 10.27 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.28 | Stock Option Agreement, dated April 9, 2001, by and between TSET, Inc. and Richard A. Papworth                           | Incorporated by reference to Exhibit 10.28 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.29 | Stock Option Agreement, dated April 9, 2001, by and between TSET, Inc. and Richard A. Papworth                           | Incorporated by reference to Exhibit 10.29 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.30 | Stock Option Agreement, dated April 9, 2001, by and between TSET, Inc. and Erik W. Black                                 | Incorporated by reference to Exhibit 10.30 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.31 | Stock Option Agreement, dated April 9, 2001, by and between TSET, Inc. and J. Alexander Chriss                           | Incorporated by reference to Exhibit 10.31 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.32 | Stock Option Agreement, dated April 9, 2001, by and between TSET, Inc. and Charles H. Wellington                         | Incorporated by reference to Exhibit 10.32 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.33 | Stock Option Agreement, dated April 9, 2001, by and between TSET, Inc. and Igor Krichtafovitch                           | Incorporated by reference to Exhibit 10.33 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.34 | Letter Agreement, dated April 10, 2001, by and between TSET, Inc. and Richard A. Papworth                                | Incorporated by reference to Exhibit 10.34 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.35 | Letter Agreement, dated April 12, 2001, by and between TSET, Inc. and Daniel R. Dwight and Richard F. Tusing             | Incorporated by reference to Exhibit 10.35 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.36 | Finders Agreement, dated April 20, 2001, by and between TSET, Inc. and Bernard Aronson, d/b/a Bolivar International Inc. | Incorporated by reference to Exhibit 10.36 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.37 | Indemnification Agreement, dated May 1,  | Incorporated by reference to   |

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|       | 2001, by and between TSET, Inc. and Jeffrey D. Wilson   | Exhibit 10.37 to the Registration Statement on Form S-1 filed on August 7, 2001                              |
| 10.38 | Indemnification Agreement, dated May 1, 2001, by and between TSET, Inc. and Daniel R. Dwight                    | Incorporated by reference to Exhibit 10.38 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.39 | Indemnification Agreement, dated May 1, 2001, by and between TSET, Inc. and Richard F. Tusing                   | Incorporated by reference to Exhibit 10.39 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.40 | Indemnification Agreement, dated May 1, 2001, by and between TSET, Inc. and Charles D. Strang                   | Incorporated by reference to Exhibit 10.40 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.41 | Indemnification Agreement, dated May 1, 2001, by and between TSET, Inc. and Richard A. Papworth                 | Incorporated by reference to Exhibit 10.41 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.42 | Indemnification Agreement, dated May 1 2001, by and between TSET, Inc. and Erik W. Black                        | Incorporated by reference to Exhibit 10.42 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.43 | Stock Option Agreement, dated May 3, 2001, by and between TSET, Inc. and Jeffrey D. Wilson                      | Incorporated by reference to Exhibit 10.43 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.44 | Common Stock Purchase Agreement, dated June 19, 2001, by and between TSET, Inc. and Fusion Capital Fund II, LLC | Incorporated by reference to Exhibit 10.44 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.45 | Registration Rights Agreement, dated June 19, 2001, by and between TSET, Inc. and Fusion Capital Fund II, LLC   | Incorporated by reference to Exhibit 10.45 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.46 | Mutual Release and Settlement Agreement, dated July 7, 2001, by and between TSET, Inc. and Foster & Price Ltd.  | Incorporated by reference to Exhibit 10.46 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.47 | Letter Agreement, dated July 9, 2001, by and between TSET, Inc. and The Eagle Rock Group, LLC                   | Incorporated by reference to Exhibit 10.47 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.48 | Finders Agreement, dated July 17, 2001, by and between TSET, Inc. and John S. Bowles                            | Incorporated by reference to Exhibit 10.48 to the Registration Statement on Form S-1 filed on August 7, 2001 |
| 10.49 | Warrant Agreement, dated July 16, 2001, by and between TSET, Inc. and The Eagle Rock Group, LLC                 | Incorporated by reference to Exhibit 10.49 to the Registration Statement on Form                             |

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S-1 filed on August 7, 2001

- 10.50 Agreement and Release, dated October 10, 2001, by and between TSET, Inc. and Jeffrey D. Wilson Incorporated by reference to Exhibit 10.50 to the Registrant's Form 10-K for the year ended June 30, 2001 filed on October 15, 2001
- 10.51 Promissory Note dated October 10, 2001 payable to Mr. Jeffrey D. Wilson Incorporated by reference to Exhibit 10.51 to the Registrant's Form 10-K for the year ended June 30, 2001 filed on October 15, 2001

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- 10.52 Consulting Agreement, dated October 10, 2001, by and between TSET, Inc. and Jeffrey D. Wilson Incorporated by reference to Exhibit 10.52 to the Registrant's Form 10-K for the year ended June 30, 2001 filed on October 15, 2001
- 10.53 Consulting Agreement effective October 1, 2001, by and among TSET, Inc., Steven G. Martin and Joshua B. Scheinfeld Incorporated by reference to Exhibit 10.53 to the Registrant's Form 10-Q for the quarterly period ended December 31, 2001 filed on November 19, 2001
- 10.54 Letter Agreement dated November 13, 2001 by and between TSET, Inc. and Fusion Capital Fund II, LLC Incorporated by reference to Exhibit 10.54 to the Registrant's Form 10-Q for the quarterly period ended December 31, 2001 filed on November 19, 2001
- 10.55 Employment Agreement, effective November 15, 2001 by and between TSET, Inc. and Daniel R. Dwight Incorporated by reference to Exhibit 10.55 to the Registrant's Form 10-Q for the quarterly period ended March 31, 2002 filed on May 15, 2002
- 10.56 Agreement, dated November 13, 2001 by and between TSET, Inc. and Fusion Capital Fund II, LLC Incorporated by reference to Exhibit 10.56 to the Registrant's Amendment No. 1 to Form S-1 filed on August 2, 2002
- 10.57 Common Stock Purchase Agreement, dated August 12, 2002 by and between between TSET, Inc. and Fusion Capital Fund II, LLC Incorporate by reference to Exhibit 10.57 to the Registrant's Form S-1 filed on August 13, 2002
- 10.58 Registration Rights Agreement, dated August 12, 2002 by and between TSET, Inc. and Fusion Capital Fund II, LLC Incorporated by reference to Exhibit 10.58 to the Registrant's Form S-1 filed on August 13, 2002
- 10.59 Termination Agreement, dated August 12, 2002 by and between TSET, Inc. and Fusion Capital Fund II, LLC Incorporated by reference to Exhibit 10.59 to the Registrant's Amendment No. 1 to Form S-1 filed on September 16, 2002
- 10.60 Master Loan and Investment Incorporated by reference to

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|       |   |   |
|-------|---|---|
|       | Agreement, dated May 9, 2003, by and among Kronos Advanced Technologies, Inc., Kronos Air Technologies, Inc. and FKA Distributing Co. d/b/a HoMedics, Inc., a Michigan corporation ("HoMedics") | the Registrant's 8-K filed on May 15, 2003  |
| 10.61 | Secured Promissory Note, dated May 9, 2003, in the principal amount of \$2,400,000 payable to HoMedics  | Incorporated by reference to Exhibit 99.2 to the Registrant's 8-K filed on May 15, 2003         |
| 10.62 | Secured Promissory Note, dated May 9, 2003, in the principal amount of \$1,000,000 payable to HoMedics  | Incorporated by reference to Exhibit 99.4 to the Registrant's 8-K filed on May 15, 2003         |
| 10.63 | Security Agreement dated May 9, 2003, by and among Kronos Air Technologies, Inc. and HoMedics   | Incorporated by reference to Exhibit 99.4 to the Registrant's 8-K filed on May 15, 2003         |
| 10.64 | Registration Rights Agreement, dated May 9, 2003, by and between Kronos and HoMedics  | Incorporated by reference to Exhibit 99.5 to the Registrant's 8-K filed on May 15, 2003         |
| 10.65 | Warrant No. 1 dated May 9, 2003, issued to HoMedics<br>8-K filed on May 15, 2003  | Incorporated by reference to Exhibit 99.7 to the Registrant's                                   |
| 10.66 | Warrant No. 2 dated May 9, 2003, issued to HoMedics   | Incorporated by reference to Exhibit 99.7 to the Registrant's 8-K filed on May 15, 2003<br>2002 |
| 10.67 | Consulting Agreement effective October 31, 2003, by and among Kronos Advanced Technologies Inc., Steven G. Martin and Joshua B. Scheinfeld  | Provided herewith   |

| EXHIBIT NO. | DESCRIPTION  | LOCATION   |
|-------------|--|--|
| 11.1        | Statement re: Computation of Earnings              | Not applicable   |
| 12.1        | Statement re: Computation of Ratios                | Not applicable   |
| 15.1        | Letter re: Unaudited Interim Financial Information | Not applicable   |
| 16.1        | Letter re: Change in Certifying Accountant         | Incorporated by reference to the Company's Form 8-K filed on |

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August 22, 2003

|      |  |                   |
|------|--|-------------------|
| 21.1 | Subsidiaries of the Registrant   | Not applicable    |
| 24.1 | Power of Attorney  | Not applicable    |
| 27.1 | Financial Data Schedule  | Not applicable    |
| 31.1 | Certification of Chief Executive Officer pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                  | Provided herewith |
| 31.2 | Certification of Principal Financial Officer pursuant to U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                 | Provided herewith |
| 32.1 | Certification by Chief Executive Officer and Principal Accounting 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 16, 2004

KRONOS ADVANCED TECHNOLOGIES, INC.

By: /S/ DANIEL R. DWIGHT

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Daniel R. Dwight  
President and Chief Executive Officer

By: /S/ DANIEL R. DWIGHT

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Daniel R. Dwight  
Acting Chief Financial Officer