

KRONOS ADVANCED TECHNOLOGIES INC
Form 10-Q
February 12, 2009

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

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

For the quarterly period ended September 30, 2008

Or

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

For the transition period from _____, _____ to _____, _____

Commission File Number: 000-30191

KRONOS ADVANCED TECHNOLOGIES, INC.
(Exact name of registrant as specified in its charter)

Nevada
(State or other jurisdiction of
incorporation or organization)

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

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

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

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

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)
company

Smaller reporting

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

Yes No

As of February 11, 2009, there were 487,626,691 shares outstanding of the issuer's common stock.

PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

The following comprise our (unaudited) consolidated financial statements for the three months ended September 30, 2008.

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KRONOS ADVANCED TECHNOLOGIES, INC.
CONSOLIDATED BALANCE SHEETS

| | September 30, 2008 (Unaudited) | June 30, 2008 (Audited) |
|---|--------------------------------------|-------------------------------|
| Assets | | |
| Current Assets | | |
| Cash | \$ 415,971 | \$ 871,970 |
| Other Current Assets | 109,372 | 151,044 |
| Total Current Assets | 525,343 | 1,023,014 |
| Net Property and Equipment | 10,298 | 11,244 |
| Intangibles | 1,473,885 | 1,546,493 |
| Total Assets | \$ 2,009,526 | \$ 2,580,750 |
| Liabilities and Stockholders' Deficit | | |
| Current Liabilities | | |
| Accounts payable | \$ 404,575 | \$ 577,028 |
| Accrued interest expenses | 543,485 | 431,300 |
| Accrued expenses | 236,527 | 323,751 |
| Accrued expenses and payables to officers | 9,617 | 6,303 |
| Deferred revenue | 615,383 | 173,074 |
| Notes payable, current portion | 4,773,559 | 4,773,559 |
| Discount for Beneficial Conversion Feature | - | (3,314,620) |
| Notes payable to officers | 110,484 | 110,484 |
| Total Current Liabilities | 6,693,630 | 3,080,879 |
| Total Liabilities | 6,693,630 | 3,080,879 |
| Stockholders' Deficit (Common stock, authorized 500,000,000 shares of \$0.001 par value; Issued and outstanding - 487,626,691 and 487,626,691, respectively) | | |
| Capital in excess of par value | 487,627 | 487,627 |
| Accumulated deficit | 36,837,962 | 36,837,962 |
| Total Stockholders' Deficit | (42,009,693) | (37,825,718) |
| Total Liabilities and Stockholders' Deficit | (4,684,104) | (500,129) |
| Total Liabilities and Stockholders' Deficit | \$ 2,009,526 | \$ 2,580,750 |

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

KRONOS ADVANCED TECHNOLOGIES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

| | Three months ended September 30, | |
|--|-------------------------------------|---------------------|
| | 2008 (Unaudited) | 2007 (Unaudited) |
| Revenues | \$ 57,691 | \$ 25,000 |
| Cost of revenues | - | - |
| Gross Profit | 57,691 | 25,000 |
| Selling, General and Administrative expenses | | |
| Compensation and benefits (includes equity compensation of \$0 and \$132,833 for the three months ended September 30, 2008 and 2007, respectively) | 339,445 | 544,489 |
| Research and development | 41,108 | 108,794 |
| Professional services | 160,633 | 169,950 |
| Depreciation and amortization | 111,721 | 109,395 |
| Insurance | 41,153 | 30,000 |
| Facilities | 40,209 | 30,550 |
| Other | 51,480 | 60,626 |
| Selling, General and Administrative expenses | 785,749 | 1,053,804 |
| Net Operating Loss | (728,058) | (1,028,804) |
| Accretion of Note | (3,314,620) | (285,660) |
| Interest Expense, Net | (141,297) | (149,012) |
| Net Loss | \$ (4,183,975) | \$ (1,463,476) |
| Net Loss Per Share | | |
| - Basic and diluted | \$ (0.01) | \$ (0.01) |
| Weighted average shares outstanding | | |
| - Basic and diluted | 487,626,691 | 242,886,244 |

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

KRONOS ADVANCED TECHNOLOGIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | For the three months ended September 30, | |
|--|---|----------------|
| | 2008 | 2007 |
| | (Unaudited) | (Unaudited) |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net loss from operations | \$ (4,183,975) | \$ (1,463,476) |
| Adjustments to reconcile net loss to net cash used in operations: | | |
| Accretion of note discount | 3,314,620 | 285,660 |
| Stock options granted for compensation/services | - | 198,516 |
| Depreciation and amortization | 111,722 | 109,395 |
| Change provided (used) in: | | |
| Accounts receivable | - | (22,321) |
| Prepaid expenses and other assets | 41,671 | - |
| Transfer of patents | - | - |
| Deferred revenue | 442,309 | - |
| Accounts payable | (172,453) | (54,101) |
| Accrued expenses and other liabilities | 28,275 | 70,430 |
| Net cash Provided (Used) in Operations | (417,831) | (875,897) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchases on property & equipment | - | (5,396) |
| Investment in patent protection | (38,168) | (62,769) |
| Net cash Used in Investing Activities | (38,168) | (68,165) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Issuance of common stock | - | 23,527 |
| Proceeds from short-term borrowings | - | 650,466 |
| Repayments of short-term borrowings | - | (12,059) |
| Proceeds from long-term borrowings | - | - |
| Repayments of long term debt | - | - |
| Net cash Provided by Financing Activities | - | 661,934 |
| NET DECREASE IN CASH | (455,999) | (282,128) |
| CASH | | |
| Beginning of period | 871,970 | 363,955 |
| End of period | \$ 415,971 | \$ 81,827 |
| Supplemental schedule of non-cash investing and financing activities: | | |
| Interest paid in cash | \$ 31,021 | \$ 29,571 |
| Taxes Paid in Cash | \$ - | \$ - |

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

KRONOS ADVANCED TECHNOLOGIES, INC.
NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 - ORGANIZATION AND NATURE OF OPERATIONS

Kronos Advanced Technologies, Inc. ("Kronos") is a Nevada corporation (the "Company"). The Company's shares began trading on the over-the-counter bulletin board exchange on August 28, 1996, under the symbol "TSET." Effective January 12, 2002, the Company began doing business as Kronos Advanced Technologies, Inc. and, as of January 18, 2002, it changed the Company ticker symbol to "KNOS" and is currently trading on the Pink Sheets.

NOTE 2 - BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Kronos have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all the information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments necessary to present fairly the information set forth therein have been included. Operating results for the three month period ended September 30, 2008 are not necessarily indicative of the results that may be experienced for the fiscal year ending June 30, 2009.

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

The accompanying consolidated financial statements should be read in conjunction with the Kronos Advanced Technologies, Inc. Form 10-KSB for the fiscal year ended June 30, 2008, which was filed with the Securities and Exchange Commission (the "SEC") on January 6, 2009.

NOTE 3 - REALIZATION OF ASSETS AND GOING CONCERN

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. The Company has sustained losses from operations in recent years, and such losses have continued through the period ending September 30, 2008. In addition, the Company has used, rather than provided, cash in its operations. The Company has attempted during the period to use its resources to commercialize its technology and develop viable commercial products and to provide for its working capital needs.

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

On September 29, 2008, Kronos received a notice of event of default from AirWorks with respect to the Secured Convertible Promissory Note due June 19, 2010 (the "Promissory Note"), issued to by the Company to AirWorks. The notice states that (1) an Event of Default under Section 2.1(a) of the Promissory Note has occurred due to the failure of the Company to make interest payments on the Promissory Note and (2) the entire principal amount of, and the interest on, the Promissory Note is declared immediately due and payable in the amount of \$3,551,735 plus interest. Airworks and Hilltop are proceeding with the foreclosure of all of the collateralized assets of the Company,

including all intellectual property and patent rights, all cash assets, all physical goods and equipment and all contractual rights including license Agreements.

During the period, Management has taken the following steps with respect to its operating and financial requirements:

Tessera. In March 2008, Kronos executed an Intellectual Property Transfer and License Agreement with Tessera Technologies, Inc. (“Tessera”) for the transfer and license of certain intellectual property (IP) rights related to Kronos proprietary technologies to Tessera. Kronos initially received \$3.5 million from Tessera in exchange for the transfer of select Kronos patents covering micro-cooling applications and for an exclusive license to the Kronos technology for the field of ionic micro-cooling of integrated circuit devices or discrete electrical components. Kronos retained the rights to use these patents for applications outside of the field of micro-cooling. Tessera has exercised its further right to acquire additional Kronos IP relating to micro-cooling applications for four quarterly payments of \$0.5 million each beginning in July 1, 2008. Kronos received a payment of \$0.5 million on July 1, 2008, a payment of \$0.5 million on October 1, 2008, and an accelerated payment of \$1.0 million on November 21, 2008, for the remaining payments due on January 1, 2009 and April 1, 2009. The receipt of this \$2.0 million constitutes payment in full for the remaining micro-cooling related patents subject to the agreement with Tessera. The Company and Tessera have the option to continue to jointly develop new technologies in this field.

EOL. In December 2005, Kronos executed a non-exclusive License Agreement with EOL LLC, a Russian Federation corporation ("EOL"). Based in Korolev, Moscow Region, Russia. EOL is leveraging the Kronos technology to produce, market, and distribute Kronos commercial air purification products, bacteriological and virus destruction devices in select Commonwealth of Independent States. The agreement comes after successful completion of multiple tests in Eastern Europe, which found the Kronos technology capable of decontaminating rooms infected with airborne viruses and bacteria. Under the terms of the five-year agreement, EOL is providing Kronos a fixed percentage royalty on every product sold, as well as upfront licensing and quarterly maintenance fees. The initial medical products are currently being marketed in Russia and marketing plans are being implanted in Ukraine, Kazakhstan, Moldova and Byelorussia. During the fiscal year ended June 30, 2008, Kronos earned \$55,000 in revenue from the sale of power supplies, other electrical components and engineering services and from the royalty from the sale of finished products by EOL. No revenue was earned from EOL during the three month period ended, September 30, 2008.

Global Appliance Manufacturers. In October 2006, a leading global home appliance manufacturer committed to fund 20% of the cost for Kronos to manufacturer a silent kitchen range hood product. This next generation range hood device represented the culmination of more than twelve months of product design and development efforts by Kronos to apply our technology to this unique embedded residential application. The product was shipped to the customer in October 2006. In January 2007, the prototype design was modified based on customer input and a revised unit was shipped to the customer. In addition to financial support, the customer has also provided Kronos with product components for Kronos testing and evaluation. In February 2007, a second global appliance manufacturer committed to purchase additional prototypes from Kronos for testing and evaluation. During the years ended June 30, 2008, Kronos earned \$34,055 in revenue from the development of prototype devices for the residential range hood market place. No revenue was earned from a global appliance manufacturer during the three month period ended, September 30, 2008.

DESA. In June 2006, the Company executed its first license for embedded applications of Kronos technology with DESA LLC ("DESA"). The agreement provided DESA the opportunity to embed the Kronos electrostatic air movement technology within fireplaces, hearth systems, zone heaters and mounted electric fans and heaters for minimum license payments. In October 2006, DESA approved Kronos' designs for the first Kronos-based product and committed to the funding of the product development by Kronos. In January 2007, DESA committed additional funds for Kronos exploration of a second Kronos-based product application. By May 2007, various prototype configurations for each of the two product applications were under test and evaluation by Kronos and DESA. Kronos does not have the funds to continue to pursue DESA applications.

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

NOTE 4 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Principles of Consolidation. The consolidated financial statements of the Company include those of the Company and its subsidiary for the periods in which the subsidiary was owned/held by the Company. All significant intercompany accounts and transactions have been eliminated in the preparation of the consolidated financial statements. At June 30, and September 30, 2008, the Company had only one subsidiary, Kronos Air Technologies, Inc.

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

financial statements and the reported amounts of revenues and expenses during the periods. Actual results could differ from those estimates.

Cash and Cash Equivalents. The Company considers all highly liquid short-term investments, with a remaining maturity of three months or less when purchased, to be cash equivalents. The Company maintains cash and cash equivalents with high-credit, quality financial institutions. At September 30, 2008 and June 30, 2008, the cash balances held at financial institutions were in excess of federally insured limits.

Property and Equipment. Property and equipment are recorded at cost. Depreciation is provided over the estimated useful lives of the assets, which range from three to seven years. Expenditures for major renewals and betterments that extend the original estimated economic useful lives of the applicable assets are capitalized. Expenditures for normal repairs and maintenance are charged to expense as incurred. The cost and related accumulated depreciation of assets sold or otherwise disposed of are removed from the accounts, and any gain or loss is included in operations.

Fair Value of Financial Instruments. Statement of Financial Accounting Standards No. 107, "Disclosures about Fair Value of Financial Instruments," requires disclosures of information about the fair value of certain financial instruments for which it is practicable to estimate the value. For purpose of this disclosure, the fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation.

The carrying amounts of the Company's short-term financial instruments, including cash, other current assets, accounts payable, accrued expenses and notes payable approximate fair value at September 30, 2008 due to the relatively short period to maturity for these instruments.

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

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

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

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

Revenue Recognition. The Company recognizes revenue in accordance with Staff Accounting Bulletin (SAB) 104, which requires evidence of an agreement, delivery of the product or services at a fixed or determinable price, and assurance of collection within a reasonable period of time. Further, Kronos Air Technologies recognizes revenue on the sale of the custom-designed contract sales under the percentage-of-completion method of accounting in the ratio that costs incurred to date bear to estimated total costs. For uncompleted contracts where costs and estimated profits exceed billings, the net amount is included as an asset in the balance sheet. For uncompleted contracts where billings exceed costs and estimated profits, the net amount is included as a liability in the balance sheet. Sales are reported net of applicable cash discounts and allowances for returns. Revenue from government grants for research and development purposes is recognized as revenue as long as the Company determines that the government will not be the sole or principal expected ultimate customer for the research and development activity or the products resulting from the research and development activity. Otherwise, such revenue is recorded as an offset to research and development expenses in accordance with the Audit and Accounting Guide, Audits of Federal Government Contractors. In either case, the revenue or expense offset is not recognized until the grant funding is invoiced and any customer acceptance provisions are met or lapse.

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

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

Recent Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations" ("SFAS 141(R)"), and SFAS No. 160, "Accounting and Reporting of Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51" ("SFAS 160"). These new standards will significantly change the financial accounting and reporting of business combination transactions and noncontrolling (or minority) interests in consolidated financial statements. SFAS 141(R) is required to be adopted concurrently with SFAS 160 and is effective for business combination transactions for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Early adoption is prohibited. The Company is currently assessing the impact that SFAS 141(R) will have on its results of operations and financial position.

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133”, which requires additional disclosures about the objectives of the derivative instruments and hedging activities, the method of accounting for such instruments under SFAS No. 133 and its related interpretations, and a tabular disclosure of the effects of such instruments and related hedged items on our financial position, financial performance, and cash flows. SFAS No. 161 is effective for the Company beginning January 1, 2009. The Company believes that, for the foreseeable future, this statement will have no impact on its financial statements once adopted.

In May 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 162, “The Hierarchy of Generally Accepted Accounting Principles.” The new standard is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. generally accepted accounting principles (GAAP) for non-governmental entities. We are currently evaluating the effects, if any, that SFAS No. 162 may have on our financial reporting.

NOTE 5 – TESSERA TRANSACTION

On March 31, 2008, Kronos executed an Intellectual Property Transfer and License Agreement with Tessera Technologies, Inc. (“Tessera”) for the transfer and license of certain intellectual property (“IP”) rights related to Kronos proprietary technologies to Tessera. Kronos received an upfront and nonrefundable fee of \$3.5 million from Tessera in exchange for the transfer of select Kronos patents covering micro-cooling applications, an exclusive license to Kronos’ additional U.S. Patents and patents pending and related foreign patent applications for ionic micro-cooling of integrated circuit devices or discrete electrical components (“Ionic Micro-cooling”); as well as a twelve month term option license to acquire additional Kronos’ U.S. Patents and related foreign patents for Ionic Micro-cooling. As of November 20, 2008, Tessera further executed its right to acquire this additional Kronos IP relating to micro-cooling applications for \$2.0 million with payments received. Kronos retained the rights to use all its patents for all applications outside of the field of micro-cooling. Upon the receipt of the \$3.5 million from Tessera, Kronos recognized \$3,269,231 as revenue for the nonrefundable, up-front license and IP transfer granted to Tessera and \$230,769 as deferred revenue for term license granted to Tessera. The deferred revenue will be recognized over the twelve month term of the license. For the three month period ending, September 30, 2008, the Company recognized \$57,691 in revenue from the initial deferred revenue associated with the first group of patents transferred. The \$2.0 million received from Tessera, in three installments between July 1, 2008 and November 20, 2008, will be recorded as revenue in a subsequent period. The company deferred \$500,000 received on July 1, 2008. These payments are for the second group of patents included in the Tessera patent sales transaction.

NOTE 6 -- INCOME TAXES

The composition of deferred tax assets and the related tax effects are as follows:

| | September 30, 2008 | June 30, 2008 |
|---|-----------------------|------------------|
| Benefit from carryforward of capital and net operating losses | \$ (9,234,840) | \$ (8,138,840) |
| Other temporary differences | (157,000) | (157,000) |
| Options issued for services | - | (806,000) |
| Less: | | |
| Valuation allowance | 9,391,840 | 9,101,840 |
| Net deferred tax asset | \$ - | \$ - |

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

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| | September 30, 2008 | | June 30, 2008 | |
|--|--------------------|-------------------|----------------|-------------------|
| | Amount | % of pre-tax Loss | Amount | % of pre-tax Loss |
| Benefit for income tax at: | | | | |
| Federal statutory rate | \$ (1,423,000) | (34.0)% | \$ (1,481,000) | (34.0)% |
| State statutory rate | (84,000) | (2.0)% | (87,000) | (2.0)% |
| Non-deductible expenses | 1,217,000 | 29.1% | 872,160 | 20.0% |
| (Decrease) Increase in valuation allowance | 290,000 | 6.9% | 695,840 | 16.0% |
| | \$ - | 0.0% | \$ - | 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.

As of September 30, 2008, the Company had approximately \$20.2 million of unused Federal net operating losses, \$1.3 million capital losses and \$16 million state net operating losses available for carryforward to future years. The benefit from carryforward of such losses will expire in various years through 2026 and could be subject to limitations if significant ownership changes occur in the Company.

NOTE 7 - SEGMENTS OF BUSINESS

The Company has only one reportable segment, which consists of developing, licensing, manufacturing and distributing air movement and purification devices utilizing the Kronos technology. For the three months ended September 30, 2008 and the fiscal year ended June 30, 2008 the Company operated only in the U.S.

NOTE 8 - EARNINGS PER SHARE

Weighted average shares outstanding used in the earnings per share calculation were 487,626,691 and 242,886,244 for the three months ended September 30, 2008 and 2007, respectively.

As of September 30, 2008, there were outstanding options to purchase 90,259,775 shares of the Company's common stock and outstanding warrants to purchase 15,792,342 shares of the Company's common stock. These options and warrants have been excluded from the earnings per share calculation as their effect is anti-dilutive. As of September 30, 2007, there were outstanding options to purchase 25,499,538 shares of the Company's common stock and outstanding warrants to purchase 42,300,000 shares of the Company's common stock. These options and warrants have been excluded from the earnings per share calculation as their effect is anti-dilutive.

NOTE 9 - CONVERTIBLE NOTES PAYABLE AND NOTES PAYABLE

On September 29, 2008, Kronos received a notice of event of default from AirWorks with respect to the Secured Convertible Promissory Note due June 19, 2010 (the "Promissory Note"), issued to by the Company to AirWorks. The notice states that (1) an Event of Default under Section 2.1(a) of the Promissory Note has occurred due to the failure of the Company to make interest payments on the Promissory Note and (2) the entire principal amount of, and the interest on, the Promissory Note is declared immediately due and payable in the amount of \$3,551,735 plus interest.

The Company had the following obligations as of September 30, 2008 and June 30, 2008

| | |
|----------------------|---------------|
| September 30 2008 | June 30, 2008 |
|----------------------|---------------|

| | | | |
|--------------------------------------|----|-----------|--------------|
| Obligations to AirWorks Funding LLLP | | | |
| (1) | \$ | 3,426,135 | \$ 3,426,135 |
| Obligations to Hilltop LLP/RS | | | |
| Properties LP(1) | | 1,147,425 | 1,147,425 |
| Discount for Beneficial Conversion | | | |
| Feature (2) | | - | (3,314,620) |
| Obligations to Gumbinner and Sun (1) | | 200,000 | 200,000 |
| Obligation to current employees (3) | | 110,484 | 110,484 |
| | | 4,884,044 | 1,569,424 |
| Less: | | | |
| Current portion | | 4,884,044 | 1,569,424 |
| Total long term obligations net of | | | |
| current portion | \$ | - | \$ - |

(1) These notes bear interest at the rate of 12% are secured by the assets of the Company and convertible into shares of Kronos Common Stock at \$0.0028 or are payable in full on June 19, 2010. On September 29, 2008, Kronos Advanced Technologies, Inc. (the "Company") received a notice of event of default from AirWorks Funding LLLP ("AirWorks") with respect to the Secured Convertible Promissory Note due June 19, 2010 (the "Promissory Note"), issued to by the Company to AirWorks, see Note 20 Subsequent Events.

(2) Under Generally Accepted Accounting Principles, the Company recorded a discount for the Beneficial Conversion Feature (“BCF”) on the convertible debt issued to AirWorks and Hilltop LLP/RS Properties. The amount of the BCF discount was calculated using the Black-Scholes model. Because the maximum value of the BCF discount cannot exceed the full value of the issued debt, the Company recorded the discount at the full value of the debt of \$3,400,000 for the period ended June 30, 2007, and an additional BCF of \$2,105,000 for the period ended June 30, 2008. The BCF recognized during 2008 was calculated for additional amounts of the notes received from Airworks and Hilltop, \$1,905,000, along with the note to Gumbinner and Sun, \$200,000. The Company is amortizing the BCF discount over the three year life of the debt. For the fiscal years ended June 30, 2008 Company recorded a discount amortization of \$2,156,225. On September 29, 2008, Kronos received a notice of event of default from AirWorks Funding LLLP (“AirWorks”) with respect to the Secured Convertible Promissory Note (the “Promissory Note”) due June 19, 2010, issued by the Company to AirWorks. As a result of the Company being served notice of default, the Company recorded \$3,314,620 amortization expense to fully amortize the remaining portion of the discount.

(3) These notes bear interest at the rate of 12%. They represent obligations to current employees of the Company, which are due in full.

NOTE 10 - COMMITMENTS AND CONTINGENCIES

In June 2007, Kronos entered into a Funding Agreement with a group of lenders providing for a loan, at the discretion of the lenders, in the aggregate amount of up to \$18,159,000. At the initial closing, the Company received an initial advance of \$4,259,000. After payment in full of the amounts due under an outstanding convertible debenture issued to Cornell Capital Partners and settlement agreement obligation to HoMedics and the expenses of the transaction, the remainder of \$1,069,000 was used for working capital purposes.

The lenders were: (i) AirWorks Funding LLLP, a newly-formed limited partnership (“AirWorks”); (ii) Critical Capital Growth Fund, L.P. and various Sands Brothers Venture Funds, all of which are affiliates of Laidlaw and Co. (UK) Ltd. (collectively “Sands”) and (iii) RS Properties I LLC, a New York-based private investment company (“RS Properties”). Subsequently, RS Properties assigned to Hilltop Holding Company, LP, a Delaware limited partnership, (“Hilltop”) its promissory note together with certain other rights and agreements relating thereto, including, without limitation, its rights and obligations under the Funding Agreement.

The loan is secured by all of the Company's assets and is convertible into shares of the Company's common stock at a conversion price of \$0.003 per share, subject to adjustment under certain circumstances. Future installments under the Funding Agreement, up to \$13,900,000, may be advanced at the discretion of the lenders, even if not requested by the Company. Under the Funding Agreement and related notes, the Company pays interest at the rate of 12% per annum. Of the total amount of the initial advance, interest is paid monthly starting July 1, 2007, on \$859,000, which principal amount is due and payable December 31, 2007. Such amount may be converted into Kronos common stock at the option of the holder at the \$0.003 conversion price only if not paid in full by December 31, 2007. On March 13, 2008, Critical Capital and Sands Brothers agreed to extend the maturity date of their note until April 30, 2008. On April 1, 2008, the Company repaid Critical Capital and Sands Brothers the full principal amount and interest on the note. With respect to all other loan amounts, interest is paid quarterly starting January 1, 2008, and outstanding principal is due and payable June 19, 2010, unless earlier converted at the option of the lenders. Assuming that the maximum loan amount is advanced under the Funding Agreement and related notes and that the lenders convert the entire amount of the loan into Kronos common stock at the noted conversion price, the lenders would own approximately 93.3% of the Company's total equity on a fully diluted, as converted basis.

Also in connection with the Funding Agreement, several Kronos option and warrant holders delivered standstill agreements pursuant to which such holders agreed not to exercise their options or warrants before December 31, 2007. Several stockholders also entered into Voting Agreements with the lenders pursuant to which they agreed to vote, if and when proposed to shareholders, in favor of: (i) a slate of directors of the Company's board of directors as

proposed by AirWorks; (ii) adjusting the size of the Company's board of directors such that upon the election of the slate of directors proposed by AirWorks, such directors hold a majority of the seats on the Company's board of directors; (iii) approving an amendment to the Company's articles of incorporation to increase the Company's authorized common stock to a number of shares necessary to allow the lenders to convert the entire amount of the financing into shares of common stock of the Company as provided in the Notes and the Funding Agreement; (iv) reincorporating the Company in Delaware; (v) a reverse stock split proposed by AirWorks or the Company's board of directors; and (vi) against any action or transaction that may reasonably be expected to impede, interfere with, delay, postpone or attempt to discourage the consummation of any of the foregoing. Such standstill and voting agreements, combined with the conversion into Kronos common stock of a sufficient amount of the initial advance under the Funding Agreement, would give the lenders voting control of the Company.

The Funding Agreement also gives the lenders the right to designate a majority of the members of the Company's Board of Directors. In accordance with the Funding Agreement, on April 14, 2008, the lenders exercised their right to designate a majority of the members of the Company's Board of Directors and five new additional Board members were appointed to the Kronos Board of Directors: Richard Perlman, Jack Silver, James Price, Marc Kloner and Barry Salzman. The Funding Agreement also contains usual and customary representations and warranties and covenants that prohibit the Company from undertaking certain actions without the consent of AirWorks.

Airworks, effective as of January 1, 2008, in agreement with the Company, agreed to defer payment of quarterly interest expenses for an unspecified period, until the Company received a Notice of Default by Airworks on September 29, 2008.

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On September 29, 2008, Kronos received a notice of event of default from AirWorks with respect to the Secured Convertible Promissory Note due June 19, 2010 (the "Promissory Note"), issued to by the Company to AirWorks. The notice states that (1) an Event of Default under Section 2.1(a) of the Promissory Note has occurred due to the failure of the Company to make interest payments on the Promissory Note and (2) the entire principal amount of, and the interest on, the Promissory Note is declared immediately due and payable in the amount of \$3,551,735 plus interest.

Daniel R. Dwight, former President and Chief Executive Officer, and the Company entered into an employment agreement effective as of November 15, 2001, and was terminated June 20, 2008. The Company and Mr. Dwight entered into a Severance Agreement dated May 16, 2008, in which the Company recorded \$243,750 as a restructuring cost in the results for the year ended June 30, 2008.

Dr. Igor Krichtafovitch resigned effective January 9, 2009. Mr. Krichtafovitch has a two year severance provision in his Employment agreement, which will be recorded as an unsecured liability for \$300,000.00.

Richard F. Tusing, as of June 20, 2008, was appointed Acting President, Acting Chief Executive Officer, Chief Operating Officer, Secretary, Treasurer and Chief Financial Officer. The Company entered into an employment agreement with Mr. Tusing effective as of January 1, 2003. The initial term of Mr. Tusing's employment agreement is for two years and will automatically renew for successive one year terms unless Kronos or Mr. Tusing provide the other party with written notice within three months of the end of the initial term or any subsequent renewal term. The Board of Directors renewed Mr. Tusing's employment agreement on October 1, 2004, October 1, 2005, October 1, 2006, October 1, 2007, and October 1, 2008. Mr. Tusing's employment agreement provides for base cash compensation of \$160,000 per year. Mr. Tusing will be entitled to fully participate in any and all 401(k), stock option, stock bonus, savings, profit-sharing, insurance and other similar plans and benefits of employment. Mr. Tusing will resign effective as of close of business on February 13, 2009. Mr. Tusing has a one year severance provision in his Employment agreement, which will be recorded as an unsecured liability for \$160,000.00. The Company has appointed Mr. Barry Salzman as the acting President, Secretary and Treasurer of the Company, effective February 13, 2009.

NOTE 11 - SUBSEQUENT EVENTS

The Company received notification from James P. McDermott and M.J. Segal on the dates of December 22, 2008 and December 23, 2008 respectively, that Mr. McDermott and Mr. Segal have resigned from the Kronos Board of Directors.

In March 2008, Kronos executed an Intellectual Property Transfer and License Agreement with Tessera Technologies, Inc. ("Tessera") for the transfer and license of certain intellectual property (IP) rights related to Kronos proprietary technologies to Tessera. Kronos initially received \$3.5 million from Tessera in exchange for the transfer of select Kronos patents covering micro-cooling applications and for an exclusive license to the Kronos technology for the field of ionic micro-cooling of integrated circuit devices or discrete electrical components. Kronos retained the rights to use these patents for applications outside of the field of micro-cooling. Tessera has exercised its further right to acquire additional Kronos IP relating to micro-cooling applications for four quarterly payments of \$0.5 million each beginning in July 1, 2008. Kronos received a payment of \$0.5 million on July 1, 2008, a payment of \$0.5 million on October 1, 2008, and an accelerated payment of \$1.0 million on November 21, 2008, for the remaining payments due on January 1, 2009 and April 1, 2009. The receipt of this \$2.0 million constitutes payment in full for the remaining micro-cooling related patents subject to the agreement with Tessera. The Company and Tessera have the option to continue to jointly develop new technologies in this field.

In December 2008 and January 2009, Kronos made principal and interest payments to Airworks and Hilltop as follows:

Airworks Interest: \$65,000 on December 31, 2008, \$545,488 on January 09, 2009, and \$1,089, January 13, 2009

Airworks principal: \$48,750 on January 9, 2009 and \$285,000 on February 4, 2009

Hilltop interest: \$62,750 on January 9, 2009, and \$12,188, January 13, 2009

Hilltop principal: \$16,250 on January 9, 2009

Since the Company has not been able to locate a purchaser for its business or assets on satisfactory terms, or otherwise cured the defaults under the Airworks and Hilltop Promissory Notes, the Company is now in the process of transferring control of its assets to Airworks and Hilltop under peaceful possession procedures.

In addition, in light of the Company's financial condition and the ongoing peaceful possession procedures with its creditors, the Company has determined that it is in its best interests to voluntarily deregister its stock with the SEC. The Company is secured to deregister because it has fewer than 500 shareholders of record and its total assets have not exceeded \$10 million on the last day of each of the three most recent fiscal years. Upon filing the applicable forms with the SEC, the Company will no longer be obligated to file certain reports with the SEC, including Forms 10-K, 10-Q and 8-K.

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

INTRODUCTORY STATEMENTS

FORWARD LOOKING STATEMENTS AND ASSOCIATED RISKS

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

GENERAL

Kronos Advanced Technologies, Inc. was a product development and production company that attempted to develop and patent technology that among other things fundamentally change the way air is moved, filtered and sterilized. Fourteen of the Company's U.S. patent applications and three international patent applications have been allowed for issuance. To date, our ability to execute our strategy has been restricted by our limited amount of capital.

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

Effective June 20, 2008, the Employment Agreement of Daniel R. Dwight, the Company's former President and Chief Executive officer, was terminated pursuant to terms of the Severance Agreement and Advisory Agreement, dated May 16, 2008. Richard F. Tusing, the Company's Chief Operating Officer, was appointed acting president, Chief Financial Officer, Treasurer and Secretary of the Company.

On October 24, 2008, the Company terminated the employment of all of its employees except for Mr. Tusing and Igor Krichtafovitch, its Chief Technology Officer. Mr Krichtafovitch resigned effective January 9, 2009. Mr. Tusing is resigning effective close of business on February 13, 2009. The Company has appointed Mr. Barry Salzman as the acting President, acting Secretary and acting Treasurer for the Company as of February 13, 2009. As a result of the Company's financial condition, it has ceased substantially all of its operating activities. Kronos is focused on prioritizing its limited resources on either selling or licensing the Company's technology or liquidating the assets of the Company.

On September 29, 2008, the Company received a notice of event of default from AirWorks with respect to the Secured Convertible Promissory Note due June 19, 2010, issued to by the Company to AirWorks. The Company has been, and continues to be, in discussions with its secured lenders regarding the outstanding obligations under the AirWorks and Hilltop promissory notes, the alleged occurrence of an event of default, and the enforcement of the rights under the promissory notes. Following the Board of Directors' appointment of James P. McDermott and M. J. Segal to an independent committee to investigate the foregoing, Mr. McDermott and Mr. Segal resigned from the Board of Directors. Since the Company was not able to locate a purchaser for its business or assets on satisfactory terms, the Company is now in the process of transferring control of its assets to AirWorks and Hilltop in accordance with peaceful possession procedures.

In addition, in light of the Company's financial condition and the ongoing peaceful possession procedures with its creditors, the Company has determined that it is in its best interests to voluntarily deregister its stock with the SEC. The Company is secured to deregister because it has fewer than 500 shareholders of record and its total assets have not exceeded \$10 million on the last day of each of the three most recent fiscal years. Upon filing the applicable forms with the SEC, the Company will no longer be obligated to file certain reports with the SEC, including Forms 10-K, 10-Q and 8-K

Technology Description and Benefits

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

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

Independent Testing - Product Claims Platform

A number of the scientific claims of the Kronos technology have been tested by the U. S. and foreign governments, multi-national companies and independent testing facilities. To date, independent laboratory testing has verified the filtration and sterilization capability of the Kronos technology. Summary results from select independent testing facilities are provided below. The tests were conducted in the U.S. unless otherwise indicated.

Filtration Testing Results:

- Environmental Health and Engineering - reduced particle matter by up to 47% compared to days when the Kronos air purifiers were not operating in the waiting room of a pediatric office while patients were present.
- Aerosol and Air Quality Research Laboratory - up to 99.8% filtration of 0.02 to 0.20 micron (20 to 200 nanometers) size particles;
- LMS Industries - removal of over 99.97% of 0.10 micron (100 nanometers) and above size particles using HVAC industry's ASHRAE 52.2 testing standard for filtration;
- MicroTest Laboratories - HEPA Clean Room Class 1000 quality particulate reduction; and
- Intertek - tobacco smoke elimination tests in accordance with ANSI/AHAM AC-1-1988 standard entitled "American National Standard Method for Measuring Performance of Portable Household Electric Cord-Connected Room Air Cleaners," which demonstrated a Clean Air Delivery Rate

("CADR") for the Kronos air purifier of over 300 for the larger size Kronos air purifier and 80 for the smaller size using consumer filtration testing standards for the Association of Home Appliance Manufacturers ("AHAM").

Sterilization Testing Results:

- Environmental Health and Engineering (viral analysis by the University of Wisconsin Department of Pediatrics and Medicine):
 - collection and removal of a wide range of respiratory viruses, including influenza A, influenza B, human rhinoviruses, human coronavirus, respiratory syncytial virus, adenovirus, and bocavirus, from the waiting room of a pediatric office while patients were present.
- Scientific Institution of Health Care, Central Clinical Hospital #2 in Moscow (clinical trial):
 - 100% decontamination of bacteria (*Staphylococcus aureus*) in under one hour and 80% decontamination of general bacteria in under 24 hours from a 48m(3) hospital room while people were present.
- Pulmonary Department of Municipal Hospital #2 in Moscow (clinical trial):
 - 100% decontamination of bacteria (*Staphylococcus aureus*) in under five hours from a 66m(3) hospital room while four patients were present; and
 - 100% decontamination of mildew fungi in under two hours from a 113.2m(3) hospital room.

- Disinfection Research Institute Sterilization Laboratory in Moscow:
 - disinfected a room completely contaminated with Bacteriophage
 - a microorganism which lives in the E. Coli bacteria. (Bacteriophage is widely used in virus testing because the microorganism's biological structure and size share many functional similarities with a wide range of viruses); and
 - 100% decontamination of room infected with bacteria (Staphylococcus aureus strain 906 (S. aureus) and Bacillus cereus strain 96 (B. cereus)
 - S. aureus is a known cause of hospital-acquired infections, including skin lesions such as boils and furunculosis and more serious infections such as pneumonia and meningitis.
- Institute for Veterinary Medicine in the Ukraine - destroy and sterilize air which had been inseminated with Anthrax and E.coli spores;
- New Hampshire Materials Laboratory - up to 95% reduction of hazardous gases, including numerous carcinogens found in cigarette smoke;
- Battelle PNNL - 95% destruction of Bg (anthrax simulant); and
- Dr. Sergey Stoylar, a bacteriologist from the American Bacteriological Society - 100% destruction of Bacillus subtilis 168 (bacteria simulant).

Medical Product Approval

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

Market Segmentation

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

Kronos has granted an exclusive license to Tessera for ionic micro-cooling of integrated circuit devices or discrete electrical components. These contracts are described in more detail in the "Technology Application and Product Development" below.

Technology Application and Product Development

To best serve Kronos' targeted market segments, the Company was developing specific product applications across two distinct product application platforms. A Kronos device can be either used as a standalone product or can be embedded. Standalone products are self-contained and only require the user to plug the Kronos device into a wall

outlet to obtain air movement and filtration for their home, office or hotel room. Embedded applications of the Kronos technology require the technology be added into another system, such as a building ventilation system for more efficient air movement and filtration or into an electrical device such as computer or medical equipment to replace the cooling fan or heat sink.

Standalone Platform

Residential Products. In October 2007, Kronos executed a Letter of Intent for the development, manufacture and sale of air purification devices based upon Kronos' proprietary air movement and purification technology with a leading national retailer. Under the terms of the Letter of Intent, the retailer has paid Kronos \$250,000 towards the development costs of the new products and would contribute marketing resources to assist in the product development process. In December 2007, Kronos completed design and developed an Alpha Prototype for the customer. In January 2008, the parties initiated negotiations of a definitive Product Development and Purchase Agreement. In February 2008, the retailer filed for bankruptcy. In March 2008, Kronos' contract manufacturing partner completed development of a Beta Prototype. During the fiscal year ended June 30, 2008, Kronos earned \$250,000 in product development fees. No fees have been earned since fiscal 2008.

Medical Products. In December 2005, the Company executed a non-exclusive license agreement with EOL LLC, a Russian Federation company ("EOL"), for manufacturing and distributing Kronos-based commercial standalone products in Russia and other select Commonwealth of Independent States. The initial medical products are currently being marketed in Russia and Ukraine and marketing plans are being implanted in Kazakhstan, Moldova and Byelorussia. In November 2006, the Ministry of Health Care and Social Development of the Russian Federation issued a Registration Certificate for the product that designates the product for medical use. During the fiscal year ended June 30, 2007, Kronos earned \$104,000 in revenue from the sale of power supplies, other electrical components and engineering services and from the royalty from the sale of finished products by EOL. During the fiscal year ended June 30, 2008, Kronos earned \$55,000 in revenue from licensing fees. No additional revenues have been earned since fiscal 2008.

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

Commercial and Other Standalone Products. Utilizing our expanded product development resources, Kronos completed the initial design, development and production of a series of small multifunctional devices that can be used as space heaters, vaporizers, disinfectors, deodorizers and/or fans.

Embedded Platform

Microelectronics Cooling Products. In December 2004, Kronos and the University of Washington were awarded a Phase I grant for a research and technology development project entitled "Heat Transfer Technology for Microelectronics and MEMS" by the Washington Technology Center (the "WTC"). The objective of the project was to develop a novel energy-efficient heat transfer technology for cooling microelectronics. In January 2006, Kronos and the University of Washington conducted a successful bench scale demonstration of micron cooling of a MEMS chip. In June 2006, the Company and the University of Washington were awarded a Phase II grant for continued funding in its novel cooling system for microelectronics and computer chips. The WTC contributed \$100,000 as a Phase II grant for the project. Kronos provided \$35,000 in funding and \$38,000 in in-kind services, including use of the Kronos Research and Product Development Facility. In June 2007, the Company and the University of Washington were awarded a Phase III grant for continued funding. This additional funding was utilized to support the development of prototype products and all Phase III deliverables were completed.

In March 2008, Kronos executed an Intellectual Property Transfer and License Agreement with Tessera Technologies, Inc. ("Tessera") for the transfer and license of certain intellectual property (IP) rights related to Kronos proprietary technologies to Tessera. Kronos initially received \$3.5 million from Tessera in exchange for the transfer of select Kronos patents covering micro-cooling applications and for an exclusive license to the Kronos technology for the field of ionic micro-cooling of integrated circuit devices or discrete electrical components. Kronos retained the rights to use these patents for applications outside of the field of micro-cooling. Tessera has exercised its further right to acquire additional Kronos IP relating to micro-cooling applications for four quarterly payments of \$0.5 million each beginning in July 1, 2008. Kronos received a payment of \$0.5 million on July 1, 2008, a payment of \$0.5 million on October 1, 2008, and an accelerated payment of \$1.0 million on November 21, 2008, for the remaining payments due on January 1, 2009 and April 1, 2009. The receipt of this \$2.0 million constitutes payment in full for the remaining

micro-cooling related patents subject to the agreement with Tessera. The Company and Tessera have the option to continue to jointly develop new technologies in this field.

Residential Products. In October 2006, a leading global home appliance manufacturer committed to fund 20% of the cost for Kronos to manufacture a silent kitchen range hood product. This next generation range hood device represented the culmination of more than twelve months of product design and development effort by Kronos to apply our technology to this unique embedded residential application. The product was shipped to the customer in October 2006. In January 2007, the prototype design was modified based on customer input and a revised unit was shipped to the customer. In addition to financial support, the customer has also provided Kronos with product components for Kronos testing and evaluation. In February 2007, a second global appliance manufacturer committed to purchase additional prototypes from Kronos. During the year ended June 30, 2007, Kronos earned \$37,000 in revenue from the development of prototype devices for the residential range hood market place. In October 2007, Kronos shipped the additional prototypes to the customer for testing and evaluation. During the year ended June 30, 2008, Kronos earned \$34,000 in product development fees. Due to a lack of funding, Kronos is no longer working on this project.

Commercial Products. In June 2006, the Company executed its first license for embedded applications of Kronos technology with DESA LLC ("DESA"). The agreement provides DESA the opportunity to embed the Kronos electrostatic air movement technology within fireplaces, hearth systems, zone heaters and mounted electric fans and heaters. In October 2006, DESA approved Kronos' designs for the first Kronos-based product and committed to the funding of the product development by Kronos. In January 2007, DESA committed additional funds for Kronos exploration of a second Kronos-based product application. By May 2007, various prototype configurations for each of the two product applications were under test and evaluation by Kronos and DESA. During the year ended June 30, 2008, Kronos and DESA developed a plan for product commercialization. Due to a lack of funding, Kronos is no longer working on this project.

In addition, Kronos has developed an air filtration and purification mechanism capable of performing to HEPA quality standards, while eliminating bacteria and viruses. The Company believes that Kronos devices could replace current HEPA filters with a permanent, easily cleaned, low-cost solution. Among the technical advantages of the Kronos technology over HEPA filters is the ability of the Kronos-based devices to eliminate the energy burden on air handling systems, which must generate high levels of backpressure necessary to move air through HEPA-based systems. Kronos-based devices enhance the air flow, while providing better than HEPA level filtration and purification. Kronos was seeking one or more strategic partners to commercialize, market and distribute Kronos based commercial embedded air filtration and purification devices; however, due to a lack of funding, the Company is no longer working on this project.

Market Segmentation

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

Patents and Intellectual Property

Kronos has received notification that fifteen of its patent applications have been allowed for issuance by the United States Patent and Trademark Office and six of its international patent applications have been allowed for issuance by the Canadian Intellectual Property Office, the Commonwealth of Australia Patent Office and the Mexican Institute of Industrial Property. These patents are considered utility patents which describe fundamental innovations in the generation, management and control of electrostatic fluids, including air movement, filtration and purification. Each of the patents contain multiple part claims for both general principles as well as specific designs for incorporating the Kronos technology into air movement, filtration and purification products. The patents provide protection for both specific product implementations of the Kronos technology, as well as more general processes for applying the unique attributes and performance characteristics of the technology.

U.S. Patents

| Date | U.S. Patent # | Patent Title | Description | Protection |
|-------------|---------------|----------------------------------|--|------------|
| August 2008 | 7,410,531 | Method of Controlling Fluid Flow | an electrode array corona including an array of corona electrodes discharge electrodes and an array of acceleration flow | 2025 |
| August | 7,262,564 | Alternative | geometry, voltage ratios | 2024 |

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|---------------|-----------|--|--|------|
| 2007 | | Geometries and power and requirements Voltage for improved Supply operational Management performance | | |
| July 2007 | 7,248,003 | Electric Field Management | effective electric field management for reduced sparking | 2025 |
| October 2006 | 7,122,070 | Method of and Apparatus for Electrostatic Fluid Acceleration | inertialess power supply for safe operation and spark prevention | 2025 |
| August 2006 | 7,157,704 | Corona Discharge Electrode and Method of Operating | method of generating air flow and air cleaning with reduced amount of ozone by-product and with extended life-span of the electrodes | 2023 |
| July 2006 | 7,150,780 | Electrostatic Air Cleaning Device | method for improving the efficiency of electrodes for filtering micron and sub-micron size particles | 2024 |
| May 2006 | 7,053,565 | Electrostatic Fluid Accelerator Power Management | effective powering of the -electrodes for high level of air velocity | 2024 |
| November 2005 | 6,963,479 | Electrostatic Fluid Accelerator - | advanced voltage management | 2023 |

Advanced Geometries impacts air filtration and sterilization, air flow and ozone as well as safe operation and spark prevention

| | | | | |
|------------------|-----------|---|--|------|
| August 2005 | 6,937,455 | Spark Management Method and Device | analysis, detection and prevention of sparks in a high voltage field - creating safe, effective electrostatic technology products | 2022 |
| July 2005 | 6,919,698 | Voltage Management for Electrostatic Fluid Accelerator | materials and geometry allowing for spark free operation and use of light weight, inexpensive materials as the electrodes | 2023 |
| May 2005 | 6,888,314 | Electrostatic Fluid Accelerator - Electrode Design Geometries | electrode design geometries and attributes including micro channeling to achieve unique air movement and purification performance | 2022 |
| April 2004 | 6,727,657 | Electrostatic Fluid Accelerator for and a Method of Controlling Fluid | synchronization of multiple stages of arrays - increasing air flow and air flow efficiency | 2022 |
| December 2003 | 6,664,741 | Method of and Apparatus for | ratio of voltage for producing ion discharge to | 2022 |

Electrostatic create air
 Fluid movement and
 Acceleration base level
 Control filtration
 of a Fluid
 Flow

| | | | | |
|---------|-----------|---------------|---|------|
| January | 6,504,308 | Electrostatic | electrode | 2019 |
| | | Fluid | density core for | |
| 2003 | | Accelerator | producing ion discharge to create air movement and base level filtration | |

International Patents

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

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

Intellectual Property Transfer

In March 2008, Kronos transferred U.S. Patents 6,919,698 and 7,157,704 and related foreign patents and patent applications to Tessera in conjunction with the execution of the Intellectual Property Transfer and License Agreement and the receipt of \$3.5 million from Tessera. The Agreement provided Tessera the additional right to acquire U.S. Patents 6,504,308 and 6,888,314 and related foreign and patent applications upon the payment of an additional \$2.0 million, which purchase was completed and transferred on November 21, 2008.

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 the Kronos technology: consumer stand-alone devices, assisted care/skilled nursing stand-alone devices, embedded devices in the hospitality industry and in specialized military applications. Expenses/cash out flows in our projections include sales and marketing, production, distribution, general and administrative expenses, research and development expenses and capital expenditures. These expenses are based on management estimates and have been compared with industry norms (relative to sales) to determine their reasonableness. We use the same key assumptions for our cash flow evaluation as we do for internal budgeting, lenders and other third parties; therefore, they are internally and externally consistent with financial statement and other public and private disclosures. We are not aware of any negative implications resulting from the projections used for purposes of evaluating the appropriateness of the carrying value of these assets. If assets are considered to be impaired, the impairment recognized is the amount by which the carrying value of the assets exceeds the fair value of the assets. Useful lives and related amortization or depreciation expense are based on our estimate of the period that the assets will generate revenues or otherwise be used by Kronos. Factors that would influence the likelihood of a material change in our reported results include significant changes in the asset's ability to generate positive cash flow, loss of legal ownership or title to the asset, a significant decline in the economic and competitive environment on which the asset depends, significant changes in our strategic business objectives and utilization of the asset.

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

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

Share-Based Compensation. We adopted SFAS No. 123R, "Share-Based Payment" ("SFAS No. 123R"), using the Modified Prospective Approach. Under the Modified Prospective Approach, the amount of compensation cost recognized includes: (i) compensation cost for all share-based payments granted before but not yet vested based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") and (ii) compensation cost for all share-based payments granted or modified based on the estimated fair value at the date of grant or subsequent modification date in accordance with the provisions of SFAS No. 123R.

RESULTS OF OPERATIONS

Consolidated Statement of Operations For the Three Months Ended September 30, 2008 ("2008") Compared with the Three Months Ended September 30, 2007 ("2007").

Our net losses for 2008 and 2007 were \$4,184,000 and \$1,463,000, respectively. The \$2,721,000, or 186%, increase in the net loss for 2008, as compared to 2007 was principally the result of a \$3,029,000 increase in accretion of note discount, partially offset by decreases in compensation of \$206,000 and research and development expenses of \$68,000 and an increase in revenue for the previous year's period of \$33,000.

Revenue. Revenues are generated through the licensing of Kronos technology and through sales of services for design and development of Kronos devices at Kronos Air Technologies, Inc. Revenues for 2008 were \$57,000 compared with \$25,000 for 2007, an increase of \$32,000. Revenues for 2008 were from our agreements with Tessera. In comparison, revenues for 2007 were from our agreements with EOL.

Cost of Sales. Cost of sales consists of the cost of the patents transferred and the product development costs associated with our transfer and development agreements. The company incurred no costs associated with patent transfers or product development for the periods ended September 30, 2008 or 2007, revenue for these periods was derived from licensing of technologies to Tessera and EOL respectively, and not cost was attributed to these revenues.

Selling, General and Administrative Expenses. Selling, General and Administrative expenses for 2008 decrease \$268,000, or 25%, to \$786,000. The decrease was principally the result of a \$206,000, or 37%, decrease in compensation and benefits primarily as a result of a \$393,000, or 266%, increase in the expense for amortization of stock options that vested, a \$288,000, or 109%, increase in professional services as a result of an increase in advisory services from our majority shareholder, as well as legal expenses and a \$190,000, or 500%, increase in product development costs.

Accretion of Note Discount. Accretion of note discount for 2008 of \$3,341,000 and 2007 of \$286,000, represented the amortization of the remaining beneficial conversion feature of the AirWorks, Hilltop, Sun and Gumbinner promissory notes during the period ending September 30, 2008.

Interest Expense. Interest expense for 2008 was \$141,000 compared to \$149,000 for the corresponding period of the prior year. The \$8,000, or 5%, decrease in interest expense for 2008, as compared to 2007, was principally the result of the decrease in the debt outstanding principal of \$413,000 for comparable periods ending September 30, 2007 to September 30, 2008.

Consolidated Balance Sheet as of September 30, 2008 Compared with June 30, 2008

Our total assets at September 30, 2008 were \$2,009,000 compared with \$2,580,000 at June 30, 2008. Total assets at September 30, 2008 and June 30, 2008 were comprised primarily of \$416,000 and \$872,000, respectively, of cash and \$1,474,000 and \$1,546,000, respectively, of patents/intellectual property. Total current assets at September 30, 2008 and June 30, 2008 were \$525,000 and \$1,023,000, respectively, while total current liabilities for such periods were \$6,693,000 and \$3,080,000, respectively. This created a working capital deficit of \$6,168,000 at September 30, 2008 and a working capital deficit of \$2,057,000 at June 30, 2008.

Stockholders' deficit as of September 30, 2008 was \$4,684,000, increased from June 30, 2008 due to the net loss of \$4,184,000 for the period ended September 30, 2008.

LIQUIDITY AND CAPITAL RESOURCES

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

Net cash flow used in operating activities was \$417,000 for the period ended September 30, 2008. We were able to satisfy most of our cash requirements for this period from the proceeds of the convertible secured promissory notes with AirWorks, Hilltop and other lenders and the proceeds from the sale of intellectual property assets and patents to Tessera, Inc.

In June 2007, Kronos entered into a Funding Agreement with a group of lenders providing for a loan, at the discretion of the lenders, in the aggregate amount of up to \$18,159,000. At the initial closing, the Company received an initial advance of \$4,259,000. After payment in full of the amounts due under an outstanding convertible debenture issued to Cornell Capital Partners and settlement agreement obligation to HoMedics and the expenses of the transaction, the remainder of \$1,069,000 was used for working capital purposes.

The lenders are: (i) AirWorks Funding LLLP, a newly-formed limited partnership ("AirWorks"); (ii) Critical Capital Growth Fund, L.P. and various Sands Brothers Venture Funds, all of which are affiliates of Laidlaw and Co. (UK) Ltd. (collectively "Sands") and (iii) Hilltop Holding Company, LP, a Delaware limited partnership, ("Hilltop").

The loan is secured by all of the Company's assets and is convertible into shares of the Company's common stock at a conversion price of \$0.003 per share, subject to adjustment under certain circumstances. Future installments under the Funding Agreement, up to \$13,900,000, may be advanced at the discretion of the lenders, even if not requested by the Company. Under the Funding Agreement and related notes, the Company pays interest at the rate of 12% per annum. Of the total amount of the initial advance, interest is paid monthly starting July 1, 2007, on \$859,000, which principal amount is due and payable December 31, 2007. Such amount may be converted into Kronos common stock at the option of the holder at the \$0.003 conversion price only if not paid in full by December 31, 2007. On March 13, 2008, Critical Capital and Sands Brothers agreed to extend the maturity date of their note until April 30, 2008. On April 1, 2008, the Company repaid Critical Capital and Sands Brothers the full principal amount and interest on the note. With

respect to all other loan amounts, interest is paid quarterly starting January 1, 2008, and outstanding principal is due and payable June 19, 2010, unless earlier converted at the option of the lenders. Assuming that the maximum loan amount is advanced under the Funding Agreement and related notes and that the lenders convert the entire amount of the loan into Kronos common stock at the noted conversion price, the lenders would own approximately 93.3% of the Company's total equity on a fully diluted, as converted basis.

The Funding Agreement also gives the lenders the right to designate a majority of the members of the Company's Board of Directors. The Funding Agreement also contains usual and customary representations and warranties and covenants that prohibit the Company from undertaking certain actions without the consent of AirWorks.

On September 29, 2008, the Company received a notice of event of default from AirWorks with respect to the Secured Convertible Promissory Note due June 19, 2010 (the "Promissory Note"), issued to by the Company to AirWorks. The notice states that (1) an Event of Default under Section 2.1(a) of the Promissory Note has occurred due to the failure of the Company to make interest payments on the Promissory Note, and (2) the entire principal amount of, and the interest on, the Promissory Note is declared immediately due and payable in the amount of \$3,551,735 plus interest.

The Company has been, and continues to be, in discussions with its secured lenders regarding the outstanding obligations under the AirWorks and Hilltop promissory notes, the alleged occurrence of an event of default, and the enforcement of the rights under the promissory notes. Following the Board of Directors' appointment of James P. McDermott and M. J. Segal to an independent committee to investigate the foregoing, Mr. McDermott and Mr. Segal resigned from the Board of Directors. Since the Company was not able to locate a purchaser for its business or assets on satisfactory terms, the Company is now in the process of transferring control of its assets to AirWorks and Hilltop in accordance with peaceful possession procedures.

GOING CONCERN OPINION

The Report of Independent Registered Public Accounting Firm includes an explanatory paragraph to their audit opinions issued in connection with our 2008 and 2007 financial statements that states that we do not have significant cash or other material assets to cover our operating costs and debt obligations. As a result of the Company's financial condition, including receipt of the notice of event of default from Airworks and the inability to obtain additional funding, there is substantial doubt about our ability to continue as a going concern. Our consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As a result of the Company's financial condition, it has discontinued substantially all of its operating activities. The Company is in the process of transferring control of its assets to Airworks and Hilltop, in accordance with peaceful possession procedures.

FACTORS AFFECTING KRONOS' BUSINESS AND PROSPECTS

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

We do not have sufficient cash to continue operations and require significant additional financing to sustain our operations, and are exploring alternatives to sell, license or liquidate the assets of the Company.

At September 30, 2008, and June 30, 2008, we had a working capital deficit of \$6.2 million and \$2.1 million, respectively. The Report of Independent Registered Public Accounting Firm for the year ended June 30, 2008, includes an explanatory paragraph stating that our recurring losses from operations and working capital deficiency raise doubt about our ability to continue as a going concern. For the fiscal years ended June 30, 2008, and 2007, we had an operating cash flow deficit of \$0.2 million and \$3.0 million and a cash balance of \$872,000 and \$364,000, respectively. Kronos has not been successful in its attempts to sell, license or liquidate partial or all of the Company's assets to satisfy secured lenders' obligations and therefore it is in the process of transferring assets to its priority creditors.

Since we do not have funds to satisfy secured loans and the alleged event of default, the Company is in the process of transferring control of its assets to its priority creditors in accordance with peaceful possession procedures.

On September 29, 2008, Kronos received a notice of event of default from AirWorks with respect to the Secured Convertible Promissory Note due June 19, 2010, issued by the Company to AirWorks. The notice stated that (1) an Event of Default under Section 2.1(a) of the Promissory Note has occurred due to the failure of the Company to make interest payments on the Promissory Note and (2) the entire principal amount of, and the interest on, the Promissory Note is declared immediately due and payable in the principal amount of \$3,551,735 plus interest. The Company requested funding from the senior lenders but was declined. The Company is evaluating the status of the alleged default.

The Funding Agreement with the Company's secured lenders provides that in the event of default, the lenders have the right to seek foreclosure of all of the assets of the Company, including all intellectual property and patent rights, all cash assets, all physical goods and equipment and all contractual rights including license Agreements. The Company has not been successful in its attempt to consummate a strategic transaction, the secured lenders have enforced their rights under the Funding Agreement and all of the Company's remaining assets are in the process of being foreclosed on and transferred to AirWorks and Hilltop.

We have a limited operating history with significant losses and have terminated our operations.

We have a limited operating history and have not been able to establish any history of profitable operations. We incurred a net loss of \$4.2 million for the quarter ended September 30, 2008, \$1.5 million for the fiscal year ended June 30, 2008, and a net loss of \$2.35 million for the fiscal year ended June 30, 2007. As a result, at September 30, 2008, June 30, 2008, and June 30, 2007, we had an accumulated deficit of \$39.1 million, \$37.8 million and \$33.5 million, respectively. Our revenues and cash flows from operations have not been sufficient to sustain our operations. On October 24, 2008, the Company terminated all but two of its employees and ceased substantially all of its operating activities. As a subsequent event, On January 9, 2009, Dr Krichtafovitch resigned from the Company. As a subsequent event, Following Acting President R. Tusing is resigning effective the close of business on February 13, 2009 and following Mr. Tusing's resignation, the Company has appointed Mr. Barry Salzman as the acting president, acting, Secretary and acting Treasurer of the Company.

Existing stockholders will experience significant dilution from the issuance of shares under our secured financing or any equity financing.

The issuance of shares pursuant to the conversion of the AirWorks and Hilltop Secured Convertible Promissory Note, the exercise of stock options and warrants or any other future equity financing transaction will have a dilutive impact on our stockholders. As a result, our net income per share could decrease in future periods, and the market price of our common stock could decline.

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

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

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

Our net intangible assets of approximately \$1.5 million as of September 30, 2008, consist principally of purchased patent technology and marketing intangibles, which relate to the acquisition of Kronos Air Technologies, Inc. in March 2000 and to the acquisition of license rights to fuel cell, computer and microprocessor applications of the Kronos technology not included in the original acquisition of Kronos Air Technologies, Inc. in May 2003 and capitalized legal costs for securing patents. Intangible assets comprise 73% of our total assets as of September 30, 2008. 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. Should 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 requirements and conditions and may not be a suitable investment.

Our common stock is deemed to be "penny stock" as that term is defined in Rule 3a51-1 promulgated under the Securities Exchange Act of 1934. Penny stocks are stocks:

- with a price of less than \$5.00 per share;

- that are not traded on a national stock exchange;

- 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.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk.

Not applicable to smaller reporting companies.

ITEM 4T. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. As of September 30, 2008, the Company carried out an evaluation, under the supervision of our Acting Chief Executive Officer and Chief Financial Officer (one individual), of the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act")) pursuant to Rule 13a-15 of the Exchange Act. It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. Based on that evaluation, the Company's Acting Chief Executive Officer and Chief Financial Officer (one individual), concluded that the Company's disclosure controls and procedures were effective at this reasonable assurance level as of September 30, 2008.

Changes in Internal Controls over Financial Reporting. In connection with the evaluation of the Company's internal controls over financial reporting during the Company's three months ended September 30, 2008, the Company's Acting Chief Executive Officer and Chief Financial Officer (one individual) has determined that there were no changes to the Company's internal controls over financial reporting during the quarter that have materially affected or is reasonably likely to affect the Company's internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

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

Thompson E. Fehr has filed a complaint in the state of Utah, in the Second Judicial District Court in Weber County, against Kronos with respect to prior services rendered to High Voltage Integrated, Inc. (HVI), based on unpaid patent counsel services totaling \$47,130 by Fehr to HVI. Fehr has filed total damages claims of \$444,900.00. The Company believes this complaint is without merit and is vigorously defending itself.

Daniel R. Dwight filed a lawsuit on October 17, 2008, in the state of Massachusetts, in Suffolk County Superior Court, against Kronos for lack of payments pursuant to the Severance Agreement dated May 16, 2008 for claims of \$187,437 plus interest and attorney fees. The Company believes its obligations to its Secured Lenders supercede the payment obligations to Mr. Dwight.

In addition, the Company received correspondence from Frederic R. Gumbinner and Richard A. Sun, as second secured lien holders, concerning claims for late payments and subsequent related penalties with respect to outstanding loans by Mr. Gumbinner and Mr. Sun. The Company has responded that the obligation to its senior secured lien holders supercedes and takes priority to the claims of the second secured lien holders and the existing intercreditor agreements among the secured lenders sets for the applicable rights, obligations and responsibilities between the lenders.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

As described above, on September 29, 2008, Kronos received a notice of event of default from AirWorks with respect to the Secured Convertible Promissory Note due June 19, 2010 (the "Promissory Note"), issued to by the Company to AirWorks. The notice states that (1) an Event of Default under Section 2.1(a) of the Promissory Note has occurred due to the failure of the Company to make interest payments on the Promissory Note and (2) the entire principal amount of, and the interest on, the Promissory Note is declared immediately due and payable in the amount of \$3,551,735 plus interest. See Part I, Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations for additional details regarding this matter.

ITEM 6. EXHIBITS

| EXHIBIT NO. | DESCRIPTION | LOCATION |
|-------------|--|--|
| 2.1 | Articles of Merger for Technology Selection, Inc. with the Nevada Secretary of State | Incorporated by reference to Exhibit 2.1 to the Registrant's Registration Statement on Form S-1 filed on August 7, 2001 (the "Registration Statement") |
| 3.1 | Articles of Incorporation | Incorporated by reference to Exhibit 3.1 to the Registration |

| | | Statement |
|-----|---|--|
| 3.2 | Bylaws | Incorporated by reference to Exhibit 3.2 to the Registration Statement |
| 31 | Certification of Principal Executive Officer and 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 | Certification by Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | Provided herewith |

Signatures

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

DATED: February 11, 2008

KRONOS ADVANCED TECHNOLOGIES, INC.

By: /s/ Richard F. Tusing
Richard F. Tusing
acting President, acting Chief Executive
Officer, acting Principal Executive Officer,
Chief Financial Officer, Principal
Financial Officer, Chief Operating Officer,
Treasurer, Secretary, and Director