SECURITY CAPITAL CORP/DE/
Form NT 10-Q
May 17, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SEC FILE NUMBER
1-7921
CUSIP NUMBER

FORM 12b-25

NOTIFICATION OF LATE FILING

(Check one):	o Form 10-K	o Form 20-F	o Form 11-K	ý Form 10-Q	o Form 10-D
	o Form N-SAR	o Form N-CSR			

For Period Ended: March 31, 2005
o Transition Report on Form 10-K
o Transition Report on Form 20-F
o Transition Report on Form 11-K
o Transition Report on Form 10-Q
o Transition Report on Form N-SAR
For the Transition Period Ended:

Read Instructions (on back page) Before Preparing Form. Please Print or Type.
Nothing in this form shall be construed to imply that the Commission has verified any information contained herein.

If the notification relates to a portion of the filing checked above, identify the Item(s) to which the notification relates:

PART I REGISTRANT INFORMATION

Security Capital Corporation
Full Name of Registrant

Former Name if Applicable

Eight Greenwich Office Park, Third Floor
Address of Principal Executive Office *(Street and Number)*

Greenwich, CT 06831
City, State and Zip Code

PART II RULES 12b-25(b) AND (c)

If the subject report could not be filed without unreasonable effort or expense and the registrant seeks relief pursuant to Rule 12b-25(b), the following should be completed. (Check box if appropriate)

o

(a) The reason described in reasonable detail in Part III of this form could not be eliminated without unreasonable effort or expense
(b) The subject annual report, semi-annual report, transition report on Form 10-K, Form 20-F, Form 11-K, Form N-SAR or Form N-CSR, or portion thereof, will be filed on or before the fifteenth calendar day following the prescribed due date; or the subject quarterly report or transition report on Form 10-Q or subject distribution report on Form 10-D, or portion thereof, will be filed on or before the fifth calendar day following the prescribed due date; and
(c) The accountant s statement or other exhibit required by Rule 12b-25(c) has been attached if applicable.

PART III NARRATIVE

State below in reasonable detail why Forms 10-K, 20-F, 11-K, 10-Q, 10-D, N-SAR, N-CSR, or the transition report or portion thereof, could not be filed within the prescribed time period.

As a result of the Company s previously announced delay in the filing of its Form 10-K for the fiscal year ended December 31, 2004 (the 2004 Form 10-K) and the Company s previously announced need to select an independent registered public accounting firm to replace Ernst & Young LLP, the Company s principal accountant, upon the completion of the Company s 2004 audit, the Company needs additional time to complete its Form 10-Q for the quarter ended March 31, 2005 (the First Quarter Form 10-Q). The Company currently expects to file the First Quarter Form 10-Q by June 30, 2005.

SEC 1344 (03-05) **Persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.**

(Attach extra Sheets if Needed)

PART IV OTHER INFORMATION

(1) Name and telephone number of person to contact in regard to this notification

Richard W. O Connor	203	625-0770
(Name)	(Area Code)	(Telephone Number)

(2) Have all other periodic reports required under Section 13 or 15(d) of the Securities Exchange Act of 1934 or Section 30 of the Investment Company Act of 1940 during the preceding 12 months or for such shorter period that the registrant was required to file such report(s) been filed ? If answer is no, identify report(s).

o Yes ý No

(3) Is it anticipated that any significant change in results of operations from the corresponding period for the last fiscal year will be reflected by the earnings statements to be included in the subject report or portion thereof?

ý Yes o No

If so, attach an explanation of the anticipated change, both narratively and quantitatively, and, if appropriate, state the reasons why a reasonable estimate of the results cannot be made.

The Company expects that there will be significant changes in its consolidated results of operations reflected in the First Quarter Form 10-Q from those reflected in its Form 10-Q for the quarter ended March 31, 2004. The Company estimates that, for the quarter ended March 31, 2005, net income will be approximately $1,515,000, or $0.23 per basic and $0.21 per diluted share. For the quarter ended March 31, 2004, the Company reported income available to common stockholders of $549,000, or $0.09 per basic and $0.06 per diluted share. In the first quarter of 2004, the Company also reported income from continuing operations of $1,240,000, or $0.17 per basic and $0.15 per diluted share. In 2004, the Company completed the sale of Pumpkin Masters Holdings, Inc. and settled the bankruptcy proceedings of Possible Dreams, Ltd., each of which had been reported as discontinued operations in the 2004 period. In addition, due to the redemption of the Company s outstanding preferred stock in the third quarter of 2004, the Company no longer reports preferred stock accretion, which had reduced net income in 2004. The estimated results for the quarter ended March 31, 2005 include approximately $2,100,000 of expenses incurred in connection with the Company s independent internal investigation, which concluded in March 2005.

Security Capital Corporation

(Name of Registrant as Specified in Charter)

has caused this notification to be signed on its behalf by the undersigned hereunto duly authorized.

Date May 17, 2005

By /s/ William R. Schlueter
Name: William R. Schlueter
Title: Senior Vice President and Chief Financial Officer

INSTRUCTION: The form may be signed by an executive officer of the registrant or by any other duly authorized representative. The name and title of the person signing the form shall be typed or printed beneath the signature. If the statement is signed on behalf of the registrant by an authorized representative (other than an executive officer), evidence of the representative s authority to sign on behalf of the registrant shall be filed with the form.

ATTENTION
Intentional misstatements or omissions of fact constitute Federal Criminal Violations (See 18 U.S.C. 1001).

GENERAL INSTRUCTIONS

1. This form is required by Rule 12b-25 (17 CFR 240.12b-25) of the General Rules and Regulations under the Securities Exchange Act of 1934.

2. One signed original and four conformed copies of this form and amendments thereto must be completed and filed with the Securities and Exchange Commission, Washington, D.C. 20549, in accordance with Rule 0-3 of the General Rules and Regulations under the Act. The information contained in or filed with the form will be made a matter of public record in the Commission files.

3. A manually signed copy of the form and amendments thereto shall be filed with each national securities exchange on which any class of securities of the registrant is registered.

4. Amendments to the notifications must also be filed on Form 12b-25 but need not restate information that has been correctly furnished. The form shall be clearly identified as an amended notification.

5. *Electronic Filers:* This form shall not be use by electronic filers unable to timely file a report solely due to electronic difficulties. Filers unable to submit reports within the time period prescribed due to difficulties in electronic filing should comply with either Rule 201 or Rule 202 of Regulations S-T (§232.201 or §232.202 of this chapter) or apply for an adjustment in filing date pursuant to Rule 13(b) of Regulation S-T (§232.13(b) of this chapter).

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nt, U.S. Navy Small Business Innovative Research Phase II contract, U.S. Army Small Business Innovative Research Phase I and Phase II contracts and our contract with a business jet manufacturer. Cost of Sales. Cost of sales for the year ended June 30, 2004 was $379,000 compared with $314,000 for the prior year. Cost of sales is primarily research and development costs and material and labor associated with our HoMedics development agreement, U.S. Navy Small Business Innovative Research Phase II contract, U.S. Army Small Business Innovative Research Phase I and Phase II contracts and contract with a business jet manufacturer. Selling, General and Administrative Expenses. Selling, General and Administrative expenses for the year ended June 30, 2004 decreased $0.8 million from the prior year to $2.1 million. The decrease was principally the result of a $801,000 reduction in professional services, and a $191,000 reduction in compensation and benefits expenses off set by a $156,000 increase in other selling, general and administrative expense. The reduction in professional services was primarily the result of (i) a reduction in legal costs as a result of the completion of the restructuring of the Company in 2003; (ii) a reduction in accounting and auditing expenses as a result of the change in public accountants in August 2003; and a reduction in consulting expenses as a result of Richard F. Tusing, our Chief Operating Officer, as a result of terminating his consulting agreements and entering into a new employment agreement with Kronos in January 2003 and (iii) the completion of a twelve month consulting agreement with the Eagle Rock Group, LLC in March 2003. The increase in other selling, general and administrative expense was primarily the result of an increase in Directors and Officers, general liability and product liability insurance. Consolidated Balance Sheet as of June 30, 2004 Our total assets at June 30, 2004 were $2.5 million compared with $3.2 million at June 30, 2003. Total assets at June 30, 2004 and June 30, 2003 were comprised primarily of $2.3 million and $2.5 million, respectively, of patents/intellectual property. Total current assets at June 30, 2004 and 2002 were $238,000 and $724,000, respectively, while total current liabilities for those same periods were $1.4 million and $1.9 million, respectively, creating a working capital deficit of $1.2 million at each respective period end. This working capital deficit is primarily due to the current portion of notes payable due to HoMedics. Stockholders' deficit as of June 30, 2004 and 2003 was ($1.4 million). The $2.5 million loss from continuing operations for the twelve months ended June 30, 2004 was offset by the sale and issuance, net of offering costs, of $1.5 million of common stock and by the transfer $0.8 million of warrants from liabilities to stockholders' deficit. 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. 15 In October 2004, Kronos entered into agreements for up to $20.5 million in equity and equity backed debt financing from Cornell Capital Partners. In October 2004, Kronos sold 5 million unregistered shares of Kronos common stock for gross proceeds of $500,000 to Cornell Capital Partners. Cornell Capital Partners committed to provide $4 million pursuant to two Promissory Notes, which have been funded as follows: $2 million upon the filing an SB-2 Registration Statement and $2 million upon the SEC declaring the Registration Statement effective. Kronos executed a Standby Equity Distribution Agreement for $20 million of funding which Kronos has the option to drawdown against in increments as large as $1.5 million over the next twenty one months. As of June 30, 2005, Kronos has received $4.5 million in funding under these agreements. In July 2005, Cornell Capital Partners suspended until further notice weekly repayments of the Kronos Promissory Note dated June 21, 2005 and suspended for one month weekly repayments of the Kronos Promissory Note dated March 7, 2005. In September 2005, Cornell Capital Partners suspended until further notice weekly repayments of the Kronos Promissory Note dated March 7, 2005. In October 2004, HoMedics agreed to extend repayment of Kronos debt and to provide an additional $1 million in funding. HoMedics has agreed to provide Kronos with an additional $1 million in financing - $925,000 in secured debt financing and $75,000 for the purchase of additional warrants. The $925,000 will be paid to Kronos upon Kronos achieving three milestones: (i) $175,000 shall be funded upon delivery and successful testing of electronic boards and power supplies from Kronos' contract manufacturing partner, (ii) $250,000 shall be funded upon obtaining tooling of the current prototype configuration and device testing and performing to HoMedics' specifications, and (iii) $500,000 shall be funded upon the initial sale of Kronos-based air purifiers by HoMedics. Kronos and HoMedics have been in discussions regarding the achievement of the first milestone. In addition, quarterly debt payments and the maturity date for existing debt have been extended. Quarterly payments due on the outstanding $2.4 million in secured debt financing, which had been scheduled to begin in August 2004, will be due the earlier of Kronos receipt of royalty payments from HoMedics sale of Kronos-based air purification products or two years. The maturity date of the $2.4 million in debt has been extended from May 2008 to October of 2009; the maturity date on the $925,000 will also be October 2009. The interest rate will remain at 6% for the $2.4 million in debt; the rate will also be 6% on the additional debt. HoMedics increased their potential equity position in Kronos to 30% of Kronos common stock on a fully diluted basis. In connection with the October 2004 agreements, Kronos issued HoMedics a warrant to buy 26.5 million shares of Kronos common stock. Net cash flow used in operating activities was $1.8 million for the year ended June 30, 2005. We were able to satisfy most of our cash requirements for this period from the proceeds of the sale of equity to Cornell Capital Partners and a group of accredited investors, the $4 million Promissory Notes with Cornell Capital Partners and our U.S. Navy and U.S. Army Phase II contracts. We estimate that achievement of our business plan will require substantial additional funding. We anticipate that the source of funding will be obtained pursuant to senior debt funding from the HoMedics Secured Promissory Note; equity funding from the Cornell Capital Standby Equity Distribution Agreement; and/or the sale of additional equity in our Company; cash flow generated from government grants and contracts; and cash flow generated from customer revenue. There are no assurances that these sources of funding will be adequate to meet our cash flow needs. GOING CONCERN OPINION The Report of Independent Registered Public Accounting Firm includes an explanatory paragraph to their audit opinions issued in connection with our 2005 and 2004 financial statements that states that we do not have significant cash or other material assets to cover our operating costs. Our ability to obtain additional funding will largely determine our ability to continue in business. Accordingly, there is substantial doubt about our ability to continue as a going concern. Our consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. We can make no assurance that we will be able to successfully develop, manufacturer and sell commercial products on a broad basis. While attempting to make this transition, we will be subject to all the risks inherent in a growing venture, including, but not limited to, the need to develop and manufacture reliable and effective products, develop marketing expertise and expand our sales force. 16 ITEM 7. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA Our consolidated financial statements appear beginning at page F-1. 17 KRONOS ADVANCED TECHNOLOGIES, INC. AND SUBSIDIARIES CONSOLIDATED FINANCIAL STATEMENTS AT JUNE 30, 2005 Report of Independent Registered Public Accounting Firm F-2 Consolidated Balance Sheets as of June 30, 2005 and June 30, 2004 F-3 Consolidated Statements of Operations for the years ended June 30, 2005 and 2004 F-4 Consolidated Statement of Changes of Stockholders' Deficit for years ended June 30, 2005 and 2004 F-5 Consolidated Statements of Cash Flows for the years ended June 30, 2005 and 2004 F-6 Notes to Consolidated Financial Statements F-7 to F-17 F - 1 REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM To the Stockholders and Board of Directors Kronos Advanced Technologies, Inc. We have audited the accompanying consolidated balance sheet of Kronos Advanced Technologies, Inc. and Subsidiary as of June 30, 2005 and 2004 and the related consolidated statements of operations, stockholders' deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kronos Advanced Technologies, Inc. and Subsidiary as of June 30, 2005 and 2004 and the results of their operations and their cash flows for the years then ended, in conformity with U. S. generally accepted accounting principles generally accepted in the United States of America. The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company has incurred significant losses and has a working capital deficiency as more fully described in Note 3. These issues among others raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 3. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. /s/ Sherb & Co., LLP -------------------------------- Sherb & Co., LLP New York, New York September 27, 2005 F - 2 KRONOS ADVANCED TECHNOLOGIES, INC. CONSOLIDATED BALANCE SHEETS June 30, June 30, 2005 2004 ------------------- ------------------- Assets Current Assets Cash $ 1,554,906 $ 69,063 Accounts receivable - 97,544 Other Current Assets 263,490 71,050 ------------------- ------------------- Total Current Assets 1,818,396 237,657 ------------------- ------------------- Property and Equipment 46,011 46,011 Less: Accumulated Depreciation (43,384) (39,719) ------------------- ------------------- Net Property and Equipment 2,627 6,292 ------------------- ------------------- Other Assets Intangibles, net 2,138,814 2,253,029 ------------------- ------------------- Total Other Assets 2,138,814 2,253,029 ------------------- ------------------- Total Assets $ 3,959,837 $ 2,496,978 =================== =================== Liabilities and Stockholders' Deficit Current Liabilities Accrued expenses and payables to officers $ 28,837 $ 36,258 Accounts payable 479,175 272,544 Accrued expenses 487,070 312,346 Deferred revenue - 3,218 Notes payable, current portion 4,028,131 798,926 Notes payable to directors & officers 397,004 - ------------------- ------------------- Total Current Liabilities 5,420,217 1,423,292 ------------------- ------------------- Long Term Liabilities Notes payable Notes payable to directors & officers - 1,063,266 Other notes payable 2,400,000 1,983,038 Discount on notes payable - (589,260) ------------------- ------------------- Total Long Term Liabilities 2,400,000 2,457,044 ------------------- ------------------- Total Liabilities 7,820,217 3,880,336 ------------------- ------------------- Stockholders' Deficit Common stock, authorized 500,000,000 shares of $.001 par value Issued and outstanding - 72,786,345 and 61,323,845, respectively 72,686 61,323 Capital in excess of par value 23,183,747 18,578,019 Accumulated deficit (27,116,813) (20,022,700) ------------------- ------------------- Total Stockholders' Deficit (3,860,380) (1,383,358) ------------------- ------------------- Total

Liabilities and Stockholders' Deficit $ 3,959,837 $ 2,496,978 ==================== ==================== The accompanying notes are an integral part of these financial statements. F - 3 KRONOS ADVANCED TECHNOLOGIES, INC. CONSOLIDATED STATEMENTS OF OPERATIONS For the year ended June 30, --------------------------------- 2005 2004 ---------------- ---------------- Sales $ 430,379 $ 533,220 Cost of sales 375,397 379,331 ---------------- ---------------- Gross Profit 54,982 153,889 ---------------- ---------------- Selling, General and Administrative expenses Compensation and benefits 1,384,481 840,205 Research and development 167,500 60,517 Professional services 244,570 355,454 Depreciation and amortization 475,250 360,955 Facilities 96,882 88,914 Insurance 173,597 125,622 Other selling general and administrative expenses 229,658 257,287 ---------------- ---------------- Total Selling, General and Administrative expenses 2,771,938 2,088,954 ---------------- ---------------- Net Operating Loss (2,716,956) (1,935,065) Other Income (Expense) Loss on Debt Restructure (3,857,467) - Other Income 1,414 56,000 Interest Expense (521,104) (615,831) ---------------- ---------------- Net Loss $ (7,094,113) $ (2,494,896) ================ ================ Basic and Diluted Loss Per Share: Net Loss $ (0.10) $ (0.04) ================ ================ Weighted Average Shares Outstanding - Basic and Diluted 67,612,904 57,760,785 ================ ================ The accompanying notes are an integral part of these financial statements. F - 4 KRONOS ADVANCED TECHNOLOGIES, INC. CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' DEFICIT Common Stock Capital in Total ---------------------- Excess of Par Accumulated Stockholders' Shares Amount Value Deficit Deficit ----------- ---------- ------------ ------------- ------------ BALANCE at June 30, 2003 53,836,524 $ 53,837 $ 16,240,378 $ (17,527,804) $(1,233,589) Stock options issued for Board Service - - 19,179 - 19,179 Shares issued for Board services 438,493 438 68,792 - 69,230 Shares issued for cash 6,705,576 6,705 1,365,513 - 1,372,218 Reclassification of redeemable warrants - - 805,300 - 805,300 Shares issued for consulting services 360,000 360 78,840 - 79,200 Adjustment to stock (16,748) (17) 17 - - Net loss for the year ended June 30, 2004 - - - (2,494,896) (2,494,896) ----------- ---------- ------------ ------------- ------------ BALANCE at June 30, 2004 61,323,845 61,323 18,578,019 (20,022,700) (1,383,358) Shares issued for cash 9,800,000 9,800 957,700 - 967,500 Shares issued for services to officers 1,500,000 1,500 133,500 - 135,000 Shares issued for consulting services 62,500 63 6,187 - 6,250 Value of warrants issued in conjunction with debt restructure - - 3,361,171 - 3,361,171 Stock options issued for Board Service - - 147,170 - 147,170 Net loss for the year ended June 30, 2005 - - - (7,094,113) (7,094,113) ----------- ---------- ------------ ------------- ------------ BALANCE at June 30, 2005 72,686,345 $ 72,686 $ 23,183,747 $ (27,116,813) $(3,860,380) =========== ========== ============ ============= ============ The accompanying notes are an integral part of this financial statement F - 5 KRONOS ADVANCED TECHNOLOGIES, INC. CONSOLIDATED STATEMENTS OF CASH FLOWS For the year ended June 30, --------------------------------------- 2005 2004 ------------------- ------------------ CASH FLOWS FROM OPERATING ACTIVITIES Net loss $ (7,094,113) $ (2,494,896) Adjustments to reconcile net loss to net cash used in operations Depreciation and amortization 475,250 360,955 Accretion of note discount 92,965 303,786 Loss on debt restructuring 3,857,467 - Common stock issued for compensation/services 282,170 167,609 Change In: Accounts receivable 97,544 (48,778) Prepaid expenses and other assets 102,447 (36,916) Deferred revenue (3,218) (130,533) Accounts payable 199,224 (596,666) Accrued expenses and other liabilities 174,710 (347,215) ------------------- ------------------ Net cash used in Operating Activities (1,815,554) (2,822,654) ------------------- ------------------ CASH FLOWS FROM INVESTING ACTIVITIES Investment in patent protection (279,245) (104,760) ------------------- ------------------ Net cash used in Investing Activities (279,245) (104,760) ------------------- ------------------ CASH FLOWS FROM FINANCING ACTIVITIES Issuance of common stock 973,750 1,372,218 Proceeds from short-term borrowings 100,000 200,000 Repayments of short-term borrowings (1,120,095) (355,396) Proceeds from long-term borrowings 4,000,000 1,138,478 Debt Acquisition Costs (373,013) - ------------------- ------------------ Net cash provided by Financing Activities 3,580,642 2,355,300 ------------------- ------------------ NET (DECREASE) INCREASE IN CASH 1,485,843 (572,114) CASH Beginning of year 69,063 641,177 ------------------- ------------------ End of year $ 1,554,906 $ 69,063 =================== ================== Supplemental schedule of non-cash investing and financing activities: Interest paid in cash $ 129,886 $ 15,667 =================== ================== Non-cash investing and financing activities: Accounts payable/accrued expenses converted to notes payable $ - $ 1,139,903 =================== ================== The accompanying notes are an integral part of this financial statement. F - 6 KRONOS ADVANCED TECHNOLOGIES, INC. AND SUBSIDIARY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 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, we changed the Company ticker symbol to "KNOS." We have confined most of our recent activities to develop the Kronos technology. NOTE 2 - 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, 2005, we had only one subsidiary, Kronos Air Technologies, Inc. Use of Estimates. The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the periods. Actual results could differ from those estimates. Concentrations of Credit Risk. Financial instruments which can potentially subject the Company to concentrations of credit risk consist principally of trade receivables. The Company manages its exposure to risk through ongoing credit evaluations of its customers and generally does not require collateral. The Company maintains an allowance for doubtful accounts for potential losses and does not believe it is exposed to concentrations of credit risk that are likely to have a material adverse impact on the Company's financial position or results of operations. Cash and Cash Equivalents. The Company considers all highly liquid short-term investments, with a remaining maturity of three months or less when purchased, to be cash equivalents. The Company maintains cash and cash equivalents with high-credit, quality financial institutions. At June 30, 2005 the cash balances held at financial institutions were in excess of federally insured limits. Accounts Receivable. The Company provides an allowance for potential losses, if necessary, on trade receivables based on a review of the current status of existing receivables and management's evaluation of periodic aging of accounts. Accounts receivable are shown net of allowances for doubtful accounts of $0 at June 30, 2005 and June 30, 2004. The Company charges off accounts receivable against the allowance for losses when an account is deemed to be uncollectable. Property and Equipment. Property and equipment are recorded at cost. Depreciation is provided over the estimated useful lives of the assets, which range from three to seven years. Expenditures for major renewals and betterments that extend the original estimated economic useful lives of the applicable assets are capitalized. Expenditures for normal repairs and maintenance are charged to expense as incurred. The cost and related accumulated depreciation of assets sold or otherwise disposed of are removed from the accounts, and any gain or loss is included in operations. Intangibles. The Company uses assumptions in establishing the carrying value, fair value and estimated lives of our long-lived assets and goodwill. The criteria used for these evaluations include management's estimate of the asset's continuing ability to generate positive income from operations and positive cash flow in future periods compared to the carrying value of the asset, the strategic significance of any identifiable intangible asset in our 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 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. F - 7 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. NOTE 3 - REALIZATION OF ASSETS 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 current year ended June 30, 2005. In addition, the Company has used, rather than provided cash in its operations. The Company is currently using its resources to attempt to raise capital necessary 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. F - 8 Management has taken the following steps with respect to its operating and financial requirements, which it believes are sufficient to provide the Company with the ability to continue in existence: HoMedics. October 2002, Kronos and HoMedics executed a Licensing Agreement granting HoMedics certain rights with respect to the distribution of the Kronos proprietary technology to the consumer. The agreement provides for exclusive North American, Australian and New Zealand retail distribution rights for next generation consumer air movement and purification products based on the patented Kronos technology. The initial term of the agreement is three and one half years from the initial sale of consumer air purification products by HoMedics, which shall be no later than December 31, 2006, with the option to extend the Licensing Agreement for six additional years. Kronos was compensated through an initial royalty payment and will receive ongoing quarterly royalty payments based on a percentage of sales. HoMedics will pay minimum royalty payments of at least $2 million during the initial three and a half year term and on-going royalty payments to extend the agreement. Kronos will retain the rights to all of its intellectual property. HoMedics commitment includes funding a marketing and advertising campaign to promote the Kronos-based product line. The products will be distributed by HoMedics. HoMedics currently distributes their products through major domestic retailers, including Wal-Mart, Home Depot, Sears, Bed Bath & Beyond, and Linens 'N Things. We believe the Company has successfully completed the development of a Kronos-based consumer standalone air purifier that is an efficient, high quality product which is cost effective and easy to operate. In March 2005, Kronos and HoMedics began expanding production development beyond the initial prototypes and initiated increased product testing to complete the product claims platform. In March and April 2005, Kronos modified the HoMedics design and ordered prototype production devices from Kronos' preferred vendors along with select components from a HoMedics preferred vendor. In August 2005, Kronos received initial shipment of products from its low cost, contract manufacturer in Mexico and China and, in September 2005, initiated testing of these products under a testing protocol co-developed by Kronos and HoMedics. U.S. Navy. In November 2002, the U. S. Navy awarded Kronos a Small Business Innovation Research Phase II contract worth $580,000, plus an option of $145,000. The Phase II contract (commercialization phase) is an extension of the Phase I and the Phase I Option work that began in 2001. It is intended that the Kronos devices developed under this contract will be embedded in existing HVAC systems in order to move air more efficiently than traditional, fan-based technology. In May 2005, Kronos shipped the Kronos device to Northrop Grumman for testing and evaluation. Based on the success of these initial tests, Northrop Grumman requested additional modifications and improvements to the device. Northrop Grumman is scheduling further testing. As of June 30, 2005, the U. S. Navy had provided Kronos with $580,000 in funding for this effort. Leading Business Jet Manufacturer. In January 2003, Kronos executed a Development and Acquisition Agreement with a premier business jet manufacturer. The Agreement was the direct result of initial prototype development work performed by the Kronos Research Team with input from the customer in 2002. The Kronos devices being designed and manufactured under this contract will need to meet all FAA safety standards, including environmental, flammability and electromagnetic interference (EMI). The Company has completed product design and development based on the customer's specific product application requirements. We are currently testing and evaluating the prototype product. Leading Automotive Manufacturer. In August 2005, Kronos extended its work into the transportation industry by signing a Prototype Development and Evaluation Agreement with a leading luxury automotive manufacturer. The Kronos devices will be designed and manufactured to meet exacting customer standards for placement inside of automobile passenger cabins. According to various industry reports, the amount of time Americans have spent in their cars has risen 236 percent since 1982 (with one report from Time Magazine noting an average motorist will spend more than 5 years stuck in traffic alone), providing optimum air circulation in automobiles is not only a comfort factor, but can also be a critical means of improving air quality and helping to prevent viruses and allergens that may otherwise accumulate in filtration systems. Washington Technology Center. In December 2004, Kronos and the University of Washington were awarded funding for a research and technology development project entitled "Heat Transfer Technology for Microelectronics and MEMS" by the Washington Technology Center ("WTC"). The objective of the project is to develop a novel energy-efficient heat transfer technology for cooling microelectronics. Thermal management for microelectronics and MEMS systems is a challenge. Existing cooling devices aren't meeting increasing needs for energy consumption and heat dissipation. Kronos air handling technology is an emerging technology that uses an electric field to exert force on ionized gas. Kronos is attempting to develop an improved microchip air handling system that is smaller in size, has high speed airflow, allows more targeted delivery of cooling to areas of highest heat and is compatible with current processes. WTC will contribute $40,000 to the project, with Kronos contributing $8,000, plus $32,000 in in-kind services, including use of the Kronos Research and Product Development Facility. During the quarter ended June 30, 2005, Kronos and the University of Washington initiated research into development of an energy-efficient heat transfer technology for cooling microelectronics. F - 9 NOTE 4 - OTHER CURRENT ASSETS Other current assets at June 30, consist of the following: 2005 2004 -------------- -------------- Debt acquisition costs $ 203,125 $ - Payroll deposit 50,000 - Lease deposits 10,365 10,365 Prepaid professional fees - 12,587 Prepaid insurance - 4,104 Work in Progress - 43,994 -------------- -------------- Prepaid and other current assets $ 263,490 $ 71,050 ============== ============== NOTE 5 - PROPERTY AND EQUIPMENT Property and equipment at June 30, consists of the following: 2005 2004 -------------- -------------- Office furniture and fixtures $ 37,756 $ 37,756 Machinery and equipment 8,255 8,255 -------------- -------------- 46,011 46,011 Less accumulated depreciation (43,384) (39,719) -------------- -------------- Net property and equipment $ 2,627 $ 6,292 =============== =============== Depreciation expense for the years ended June 30, 2005 and 2004 were $3,655 and $13,283, respectively. NOTE 6 - INTANGIBLES Intangible assets at June 30, consists of the following: 2005 2004 --------------- --------------- Marketing intangibles $ 587,711 $ 587,711 Purchased patent technology 2,669,355 2,669,355 Developed patent technology 518,960 239,715 --------------- --------------- 3,776,026 3,496,781 Less accumulated amortization (1,637,212) (1,243,752) --------------- --------------- Net intangible assets $ 2,138,814 $ 2,253,029 =============== =============== Purchased patent technology includes property that was acquired in the Kronos acquisition. Intangible assets are being amortized on a straight line basis over 10 years. Amortization expense for the years ended June 30, 2005 and 2004 was $393,460 and $271,364, respectively. Amortization of the Company's Intangible Assets shown above for the fiscal years ended June 30, 2006 2007 2008 2009 2010 ----------- ----------- ----------- ----------- ----------- Marketing intangibles $ 587,711 $ 587,711 $ 587,711 $ 587,711 $ 587,711 Purchased patent technology 2,669,355 2,669,355 2,669,355 2,669,355 2,669,355 Developed patent technology 518,960 518,960 518,960 518,960 518,960 ----------- ----------- ----------- ----------- ----------- 3,776,026 3,776,026 3,776,026 3,776,026 3,776,026 Less accumulated amortization (2,014,815) (2,392,418) (2,770,021) (3,147,624) (3,434,800) ----------- ----------- ----------- ----------- ----------- Net intangible assets $1,761,211 $1,383,608 $1,006,005 $ 628,402 $ 341,226 =========== =========== =========== =========== =========== F - 10 NOTE 7 - ACCRUED EXPENSES Accrued expenses at June 30, consisted of the following: 2005 2004 --------------- --------------- Accrued compensation $ 21,344 $ 55,913 Accrued interest 428,712 166,276 Accrued professional services 37,014 90,157 --------------- --------------- $ 487,070 $ 312,346 =============== =============== NOTE 8 - NOTES PAYABLE The Company had the following obligations as of June 30, 2005 and 2004, 2005 2004 --------------- --------------- Obligations to Cornell Capital(1) $ 4,000,000 $ - Obligation to HoMedics (2) 2,400,000 2,400,000 Discount on obligation to HoMedics - (589,260) Obligation to current employees (3) 397,004 1,139,903 Obligation for finance leases (4) 28,131 50,327 Obligation to Fusion Capital (5) - 200,000 Obligations to others (6) - 55,000 --------------- --------------- 6,825,135 3,255,970 Less: Current portion 4,425,135 798,926 --------------- --------------- Total long term obligations net of current portion $ 2,400,000 $ 2,457,044 =============== =============== (1) These notes have a one year term and bear interest at 12% with weekly payments. (2) This note has a 5 year term and bears interest at 6% with no payments required until the earlier of Kronos receipt of royalty payments from HoMedics sale of Kronos-based air purification products or two years. This note was issued along with warrants for the purchase of 13.4 million shares of the Company's common stock. (3) These notes bear interest at the rate of 12%. They represent obligation to current employees of the Company, which are due by December 31, 2006. (4) See Note 9 below. (5) This was a non-interest bearing demand obligation and was outstanding until November 2004 when Fusion Capital purchased enough stock from the Company to eliminate the advance position. (6) This obligation was originally incurred for the acquisition of license rights of the Kronos technology (see note 7) with a value of $270,000. This note was non-interest bearing with quarterly payments of $30,000 until paid it was paid in full on October 5, 2004. Payout of the Company's Notes Payable obligations listed above for the fiscal years ended June 30, 2006 2007 2008 2009 2010 ----------- ---------- ---------- ---------- ---------- Obligations to Cornell Capital $4,000,000 $ - $ - $ - $ - Obligation to current employees 397,004 - - - - Obligation for finance leases 28,131 Obligation to HoMedics - 553,846 738,846 738,462 369,231 ----------- ---------- ---------- ---------- ---------- $4,425,135 $ 553,846 $ 738,462 $ 738,462 $ 369,231 =========== ========== ========== ========== ========== F - 11 NOTE 9 - LEASES The Company has entered into a non-cancelable operating lease for facilities. Rental expense was approximately $66,600 and $66,500 for years ended June 30, 2005 and 2004 respectively. Effective October 1, 2005, Kronos is committed through September 30, 2009 to annual lease payments on operating leases for 6,000 square feet of office/research and product development premises of for rent during fiscal, 2006 2007 2008 2009 ---------- --------- --------- --------- Lease payments $ 58,800 $60,564 $ 62,388 $ 64,260 ========== ======== ========= ========= The Company has entered into capital leases for equipment. The leases are for 36 months and contain bargain purchase provisions so that the Company can purchase the equipment at the end of each lease. The following sets forth the minimum future lease payments and present values of the net minimum lease payments under these capital leases: Year ended June 30, 2006 $ 31,550 ------------ Total minimum lease payments 31,550 Less: Imputed interest (3,419) ------------ Present value of net minimum lease payments $ 28,131 ============ In the year ended June 30, 2005 the Company paid $22,197 in principal and $8,493 in interest on capital leases. Of the equipment that was purchased using capital leases, $10,650 was capitalized and the remaining $65,781 was expensed through research and development and cost of sales. NOTE 10 - NET LOSS PER

SHARE As of June 30, 2005, there were outstanding options to purchase 14,989,782 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 loss per share calculation as their effect is anti-dilutive. As of June 30, 2004 there were outstanding options to purchase 12,813,812 shares of Kronos common stock and outstanding warrants to purchase 15,792,342 shares of Kronos common stock. These options and warrants have been excluded from the loss per share calculation as their effect is anti-dilutive. NOTE 11 - INCOME TAXES The composition of deferred tax assets and the related tax effects at June 30, 2005 and 2004 are as follows: 2005 2004 --------------- --------------- Benefit from carryforward of capital and net operating losses $ 6,091,927 $ 4,841,083 Other temporary differences 156,740 156,740 Less: Valuation allowance (6,248,667) (4,997,823) --------------- --------------- 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: F - 12 June 30, --- 2005 2004 --- Amount % of pre-tax Loss Amount % of pre-tax Loss --- Benefit for income tax at: Federal statutory rate $ 2,411,998 34.0% $ 848,265 34.0% State statutory rate 141,882 2.0% 49,728 2.0% Non-deductible expenses (1,303,036) (18.4)% (123,348) 11.6% Increase in valuation allowance (1,250,844) (17.6)% (774,645) (47.6)% --- $ - 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. At June 30, 2005, for federal income tax and alternative minimum tax reporting purposes, the Company has approximately $14.5 million of unused Federal net operating losses, $2.3 million capital losses and $10.3 million State net operating losses available for carryforward to future years. The benefit from carryforward of such losses will expire in various years between 2006 and 2023 and could be subject to limitations if significant ownership changes occur in the Company. NOTE 12 - CONSULTING AGREEMENTS On October 31, 2003, the Company entered into a 10 month consulting agreement with Joshua B. Scheinfeld and Steven G. Martin for consulting services with respect to operations, strategy, capital structure and other matters as specified from time to time. As consideration for their services, the Company issued 360,000 shares of its common stock. In accordance with Emerging Issues Task Force ("EITF") 96-18, the measurement date was established as the contract date of October 31, 2003 as the share grant is non-forfeitable and fully vested on that date. The stock was valued on that date at $0.22 a share (the closing price for the Company's common stock on the measurement date). The stock issuance, valued at $79,200 was recorded as a prepaid consulting fee and was amortized to Professional Fee Expense ratably over the 10 month term of the contract. Under this contract, expenses of $15,840 and $63,360 were recorded for the years ended June 30, 2005 and 2004, respectively. NOTE 13 - STOCK OPTIONS AND WARRANTS On February 12, 2002, the Board of Directors approved the TSET, Inc. Stock Option Plan under which Kronos' key employees, consultants, independent contractors, officers and directors are eligible to receive grants of stock options. Kronos has reserved and issued a total of 6,250,000 shares of common stock under the Stock Option Plan. Prior to that, the Company had no formal stock option plan but offered as special compensation to certain officers, directors and third party consultants the granting of non-qualified options to purchase Company shares at the market price of such shares as of the option grant date. The options generally have terms of three to ten years. The Company granted non-qualified stock options totaling 2,450,000 and 3,239,782 shares in the years ended June 30, 2005 and 2004, respectively. As of July 1, 2004, the Company elected to follow Statement of Financial Accounting Standards No. 123R, Share-Based Payment ("SFAS No. 123R") 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). The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in the Company's opinion the existing available models do not necessarily provide a reliable single measure of the fair value of the Company's employee stock options. Using the Black-Scholes option valuation model, the weighted average grant date fair value of options granted during the years ended June 30, 2005 and 2004 was $0.68 and $0.18 per option share, respectively. F - 13 A summary of the Company's stock option activity and related information for the years ended June 30, 2005 and 2004 is as follows (in thousands, except per share amounts): Weighted Average Shares Exercise Price --------------- ------------ Outstanding at June 30, 2003 10,102 $ 0.52 Granted 3,240 0.19 Exercised - - Cancelled (529) 0.89 --------------- ------------ Outstanding at June 30, 2004 12,813 0.42 Granted 2,450 0.15 Exercised - - Cancelled (273) 0.84 --------------- ------------ Outstanding as June 30, 2005 14,990 $ 0.37 =============== ============ A summary of options outstanding and exercisable at June 30, 2005 and 2004 is follows (in thousands, except per share amounts and years): Options Outstanding Options Exercisable --- ------------------------------ Weighted Average Remaining Weighted Range of Life (in Average Range of Exercise Prices Options years) Exercise Price Exercise Prices Options ----------------- -------- ---------- -------------- --------------- -------- June 30, 2005 $0.71 - $1.12 1,472 2.9 $0.87 $0.71 - $1.12 1,472 $0.21 - $0.70 5,925 6.3 $0.49 $0.21 - $0.70 5,925 $0.00 - $0.20 7,593 8.0 $0.17 $0.00 - $0.20 7,593 June 30, 2004 $0.71 - $1.12 1,670 3.5 $0.89 $0.71 - $1.12 1,670 $0.21 - $0.70 5,975 7.3 $0.49 $0.21 - $0.70 5,975 $0.00 - $0.20 5,168 8.8 $0.18 $0.00 - $0.20 5,168 A summary of the Company's stock warrant activity and related information for the years ended June 30, 2005 and 2004 is as follows (in thousands, except per share amounts): Weighted Average Warrants Exercise Price ---------------- ------------ Outstanding at June 30, 2003 15,792 $0.16 Granted - - Exercised - - Cancelled - - --------------- ------------ Outstanding as June 30, 2004 15,792 $ 0.16 Granted 26,508 0.10 Exercised - - Cancelled - - --------------- ------------ Outstanding as June 30, 2005 42,300 $ 0.12 =============== ============ NOTE 14 - COMMITMENTS AND CONTINGENCIES In October 2004, Kronos entered into agreements for up to $20.5 million in equity and equity backed debt financing from Cornell Capital Partners. In October 2004, Kronos sold 5 million unregistered shares of Kronos common stock for gross proceeds of $500,000 to Cornell Capital Partners. Cornell Capital Partners committed to provide $4 million pursuant to two Promissory Notes, which had been funded as follows: $2 million upon the filing an SB-2 Registration Statement and $2 million upon the SEC declaring the Registration Statement effective. Kronos executed a Standby Equity Distribution Agreement for $20 million of funding which Kronos has the option to drawdown against in increments as large as $1.5 million over the next twenty one months. As of June 30, 2005, Kronos has received $4.5 million in funding under these agreements. F - 14 In October 2004, HoMedics agreed to extend repayment of Kronos debt and to provide an additional $1 million in funding. HoMedics has agreed to provide Kronos with an additional $1 million in financing - $925,000 in secured debt financing and $75,000 for the purchase of additional warrants. The $925,000 will be paid to Kronos upon Kronos achieving three milestones: (i) $175,000 shall be funded upon delivery and successful testing of electronic boards and power supplies from Kronos' contract manufacturing partner, (ii) $250,000 shall be funded upon obtaining tooling of the current prototype configuration and device testing and performing to HoMedics' specifications, and (iii) $500,000 shall be funded upon the initial sale of Kronos-based air purifiers by HoMedics. Kronos and HoMedics have been in discussions regarding the achievement of the first milestone. In addition, quarterly debt payments and the maturity date for existing debt have been extended. Quarterly payments due on the outstanding $2.4 million in secured debt financing, which had been scheduled to begin in August 2004, will be due the earlier of Kronos receipt of royalty payments from HoMedics sale of Kronos-based air purification products or two years. The maturity date of the $2.4 million in debt has been extended from May 2008 to October of 2009; the maturity date on the $925,000 will also be October 2009. The interest rate will remain at 6% for the $2.4 million in debt; the rate will also be 6% on the additional debt. HoMedics increased their potential equity position in Kronos to 30% of Kronos common stock on a fully diluted basis. In connection with the October 2004 agreements, Kronos issued HoMedics a warrant to buy 26.5 million shares of Kronos common stock. As a result of this debt restructuring, the Company recognized a loss of $3,857,467 which represents the reacquisition price less the net carrying value of the debt restructuring. The reacquisition price is made up of $2,400,000 which is the amount of the new debt and $3,361,161 which represents the value of the warrants using the Black-Scholes method. The net carrying value is the $2,400,000 which is the old debt less the unamortized debt discount of $496,296. Daniel R. Dwight, President and Chief Executive Officer, and the Company entered into an Employment agreement effective as of November 15, 2001. The initial term of Mr. Dwight's Employment Agreement was for 2 years and will automatically renew for successive 1 year terms unless Kronos or Mr. Dwight provide the other party with written notice within 3 months of the end of the initial term or any subsequent renewal term. The Board of Directors renewed Mr. Dwight's Employment Agreement on August 13, 2003 and again on August 15, 2004 and August 15, 2005. Mr. Dwight's Employment Agreement provides for base cash compensation of

$180,000 per year. Mr. Dwight is eligible for annual incentive bonus compensation in an amount equal to Mr. Dwight's annual salary based on the achievement of certain bonus objectives. In addition, Kronos granted Mr. Dwight 1,000,000 immediately vested and exercisable, ten-year stock options at various exercise prices. Mr. Dwight 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. Richard F. Tusing, Chief Operating Officer, and the Company entered into an Employment agreement effective as of January 1, 2003. The initial term of Mr. Tusing's Employment Agreement is for 2 years and will automatically renew for successive 1 year terms unless Kronos or Mr. Tusing provide the other party with written notice within 3 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. 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. NOTE 15 - MAJOR CUSTOMERS As of June 30, 2005 the Company had three major customers: HoMedics, the U.S. Navy and the U.S. Army. Of the $430,379 in revenue recorded in the year ended June 30, 2005, $430,379 or 100% was derived from these three customers. As of June 30, 2004, the Company had two major customers: HoMedics and the U.S. Navy. Of the $533,220 in revenue recorded in the year ended June 30, 2004, $477,032 or 89% was derived from these two customers. F - 15 NOTE 16 - SEGMENTS OF BUSINESS The Company operates principally in one segment of business: The Kronos segment licenses, manufactures and distributes air movement and purification devices utilizing the Kronos technology. In the year ended June 30, 2005, the Company operated only in the United States of America. NOTE 17 - RELATED PARTIES As of June 30, 2005, the Company has outstanding obligations for past compensation to management of $397,004. As of June 30, 2004, the Company has outstanding obligations for past compensation management of $1,139,903. These unpaid amounts currently accrue interest at the rate of 12% per annum. NOTE 18 - STOCKHOLDERS' DEFICIT During the year ended June 30, 2005, the Company issued 9,800,000 shares of its common stock for $967,500 in cash. The Company issued 1,500,000 shares valued at $135,000 for services to officers and employees and 62,500 shares valued at $6,250 for consulting services. During the year ended June 30, 2004, the Company issued 6,705,576 shares of its common stock for $1,403,718 in cash. The Company issued 360,000 shares valued at $79,200 for consulting services and 438,493 shares of its common stock valued at $69,230 for board service to current members of the Board of Directors. NOTE 19 - SUBSEQUENT EVENTS In July 2005, Cornell Capital Partners suspended until further notice weekly repayments of the Kronos Promissory Note dated June 21, 2005 and suspended for one month weekly repayments of the Kronos Promissory Note dated March 7, 2005. In September 2005, Cornell Capital Partners suspended until further notice weekly repayments of the Kronos Promissory Note dated March 7, 2005. In July, August and September 2005, Kronos issued 6,843,857 shares of common stock for $460,000 to Cornell under the terms of our Standby Equity Distribution Agreement. The proceeds were used to make payments on the two Promissory Notes. In August 2005, Kronos extended its work into the transportation industry by signing a Prototype Development and Evaluation Agreement with a leading luxury automotive manufacturer. The Kronos devices will be designed and manufactured to meet exacting customer standards for placement inside of automobile passenger cabins. F - 16 ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE None. ITEM 8A. CONTROLS AND PROCEDURES Evaluation of Disclosure Controls and Procedures. Within 90 days prior to the filing date of this report, our Company carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures pursuant to Exchange Act Rules 13a-15(e) and 15d-15(e). This evaluation was done under the supervision and with the participation of our Company's President and Chief Financial Officer. Based upon that evaluation, they concluded that our Company's disclosure controls and procedures are effective in gathering, analyzing and disclosing information needed to satisfy our Company's disclosure obligations under the Exchange Act. Changes in Internal Controls. There were no significant changes in our Company's internal controls or in other factors that could significantly affect those controls since the most recent evaluation of such controls. PART III ITEM 9. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT Our directors and executive officers and their ages as of October 8, 2004, are as follows: NAME AGE POSITION ------------------- ----- -------------------------------------- Daniel R. Dwight 45 Director; President and Chief Executive Officer Richard F. Tusing 48 Director; Chief Operating Officer James P. McDermott 43 Director M. J. Segal 60 Director Daniel R Dwight, 45, has served as a Director of Kronos since November 2000, and as a Director and Chief Executive Officer of Kronos Air Technologies since January 2001. Effective October 16, 2001, Mr. Dwight was appointed President and Chief Executive Officer of Kronos. Effective January 1, 2004, Mr. Dwight was appointed Acting Chief Financial Officer of Kronos. He has extensive experience in private equity and operations in a wide variety of high growth and core industrial businesses. Mr. Dwight spent 17 years with General Electric including 10 years of operations, manufacturing, and business development experience with GE's industrial businesses, and seven years of international investment and private equity experience with GE Capital. He has had responsibility for over a $1 billion in merger and acquisition and private equity transactions at GE. Mr. Dwight initiated GE Capital's entry in the Asia private equity market. Between 1995 and 1999, the Asian equity portfolio grew to include consolidations, leveraged buyouts, growth capital and minority investments in diverse industries, including information technology, telecommunications services, consumer products, services and distribution, and contract manufacturing. Since 1982, Mr. Dwight has held other leadership positions domestically and internationally with GE Capital, as well as senior positions with GE Corporate Business Development (1989-1992) and GE Corporate Audit Staff (1984-1987). Mr. Dwight holds an MBA in Finance and Marketing with Honors from The University of Chicago Graduate School of Business and a B.S. in Accounting with Honors from the University of Vermont and is a member of the Association of Heating, Ventilation, Air conditioning and Refrigeration Engineers, Inc. (ASHRAE). 16 Richard F. Tusing, 48, has served as a Director of Kronos since October 2000 and as a Director of Kronos Air Technologies since January 2001 and was appointed Chief Operating Officer on January 1, 2002. Mr. Tusing has had extensive experience in developing new enterprises, negotiating the licensing of intellectual property rights, and managing technical and financial organizations, and has more than 20 years of business development, operations, and consulting experience in the technology and telecommunications industries. Prior to his services to Kronos, Mr. Tusing spent four years in executive management with several emerging technology companies, 14 years in various managerial and executive positions with MCI Communications Corporation, and three additional years in managerial consulting. From 1982-1996, Mr. Tusing held multiple managerial and executive positions with MCI Communications Corporation. From 1994-1996, he served as MCI's Director of Strategy and Technology, managing MCI's emerging technologies division (having primary responsibility for evaluating, licensing, investing in, and acquiring third-party technologies deemed of strategic importance to MCI), and also oversaw the development of several early-stage and venture-backed software and hardware companies; in this capacity, Mr. Tusing managed more than 100 scientists and engineers developing state-of-the-art technologies. From 1992-1994, Mr. Tusing founded MCI Metro, MCI's entree into the local telephone services business and, as MCI Metro's Managing Director, managed telecommunications operations, developed financial and ordering systems, and led efforts in designing its marketing campaigns. From 1990-1992, he served as Director of Finance and Business Development for MCI's western region. From 1982-1990, Mr. Tusing held other management and leadership positions within MCI, including service as MCI's Pacific Division's Regional Financial Controller, Manager of MCI's Western Region's Information Technology Division, and led MCI's National Corporate Financial Systems Development Organization. Mr. Tusing received B.S. degrees in business management and psychology from the University of Maryland in 1979. James P. McDermott, 43, became a Director of Kronos in July 2001. Mr. McDermott has over 20 years of financial and operational problem-solving experience. Mr. McDermott is a co-founder and is currently a Managing Director of Eagle Rock Advisors, LLC, the Manager for The Eagle Rock Group, LLC. From 1992 through 2000, Mr. McDermott held various managerial and executive positions with PennCorp Financial Group, Inc. and its affiliates. From 1998 through 2000, Mr. McDermott was Executive Vice-President and Chief Financial Officer of PennCorp Financial Group. While serving in this position, Mr. McDermott was one-third of the executive management team that was responsible for developing and implementing operational stabilization, debt reduction and recapitalization plans for the company. From 1995 through 1998, Mr. McDermott served as Senior Vice-President of PennCorp Financial Group. Mr. McDermott worked closely with the Audit Committee of the Board of Directors on evaluating the PennCorp's accounting and actuarial practices. In addition, Mr. McDermott was responsible for developing a corporate-wide technology management program resulting in technology convergence and cost savings to the company's technology budget. From 1994 through 1998, Mr. McDermott was a principal in Knightsbridge Capital Fund I, LP, a $92 million investment fund specializing in leverage-equity acquisitions of insurance and insurance-related businesses. Mr. McDermott was also the founding Chairman of the e-business Internet service provider, Kivex.com, and a senior manager of one of the world's leading public accounting firms, KPMG. Mr. McDermott received a B.S. Degree in Business Administration from the University of Wisconsin, Madison. M. J. Segal, 60, became a Director of Kronos in September 2003. Mr. Mr. Segal has over 35 years of corporate governance, entrepreneurial and investment banking expertise. Mr. Segal founded the investment banking firm of M.J. Segal Associates in 1987. Since 1992, the firm has specialized in researching private equity opportunities in both private and emerging growth public companies. The Segal group caters primarily to institutional clients, private investment partnerships and professional money managers. After starting his career as a stockbroker and financial planner in 1966 with Philadelphia based New York Stock Exchange firm, Robinson & Company, Mr. Segal joined Josephthal & Co. Inc., a leading full-service investment banking and brokerage firm in New York. Mr. Segal has served as senior vice president of the congressionally charted National Corporation for Housing Partnerships in Washington, D. C. and president of its investment banking subsidiary and has qualified as a NASD broker/dealer financial principal. Originally from Philadelphia, Mr. Segal attended the Wharton School of the University of Pennsylvania and is a graduate of The New York Institute of Finance. 17 DIRECTORS Our Board of Directors consists of eight seats. Directors serve for a term of one year and stand for election at our annual meeting of stockholders. Three of our current directors were elected at our annual meeting of stockholders held on December 30, 2002, and two additional directors were appointed in August and September 2003, respectively. In April 2005, Spencer Browne, a Member of the Kronos Board of Directors passed away. Mr. Browne had served as a Board Member since August 2003. Four vacancies currently exist on the Board of Directors as of the date of this filing. Pursuant to our Bylaws, a majority of directors may appoint a successor to fill any vacancy on the Board of Directors. ADVISORY BOARD We established an Advisory Board in July 2001 to assist management in the development of long-range business plans for our Company. Currently, William Poster and Charles Strang are the only Advisory Board Members. Mr. Poster is a seasoned entrepreneur with a successful track record as a founder of several businesses spanning five continents. Mr. Poster has experience in developing business opportunities in the United States, Europe, Asia and the Middle East. Mr. Poster recently stepped down as President of Computer Systems & Communications Corporation, a wholly-owned subsidiary of General Dynamics. Computer Systems & Communications Corporation is a cutting-edge communications and technology company that Mr. Poster founded and later sold to General Dynamics. Mr. Poster is currently a principal with Eagle Rock Advisors, LLC. Mr. Strang is a former Kronos Director from January 2001 through December 2002. Mr. Strang was named National Commissioner of NASCAR (National Association for Stock Car Auto Racing, Inc.) in 1998 and continues to serve in that capacity. In 1989 Mr. Strang received President Bush's American Vocation Success Award; in 1992 was elected to the Hall of Fame of the National Marine Manufacturers Association; in 1990 was awarded the Medal of Honor of the Union for International Motorboating; and is a life member of the Society of Automotive Engineers. He also currently serves as a Director of the American Power Boat Association (the U.S. governing body for powerboat racing) and Senior Vice-President of the Union for International Motorboating (the world governing body for powerboat racing, with approximately 60 member nations). We will continue to evaluate additional potential candidates for our Advisory Board. COMMITTEES On September 11, 2001, the Board of Directors established a Compensation Committee consisting of at least two independent members of the Board of Directors. The Compensation Committee is charged with reviewing and making recommendations concerning Kronos' general compensation strategy, reviewing salaries for officers, reviewing employee benefit plans, and administering Kronos' stock incentive plan, once adopted and implemented. Messrs. McDermott and Segal are the current members of the Compensation Committee. During the year the Compensation Committee held two meetings. Each member attended at least 75% of the meetings. On September 4, 2003, the Board of Directors established an Executive Committee. The purpose of the Executive Committee is to exercise all the powers and authority of the Board of Directors in the management of the property, affairs and business of the Company. The Committee shall consist of no fewer than three members, including the Chief Executive Officer of the Company. Messrs. Dwight, McDermott, Segal and Tusing are the current members of the Executive Committee. On September 10, 2003, the Board of Directors established an Audit Committee consisting of at least two independent members of the Board of Directors. The Audit Committee is charged with providing independent and objective oversight of the accounting functions and internal controls of the Company and its subsidiaries to ensure the objectivity of the Company's financial statements. Messrs. McDermott and Segal are the current members of the Audit Committee. During the year the Audit Committee held three meetings. Each member attended at least 75% of the meetings. COMPENSATION OF DIRECTORS Cash Compensation. Our Bylaws provide that, by resolution of the Board of Directors, each director may be reimbursed his expenses of attendance at meetings of the Board of Directors; likewise, each director may be paid a fixed sum or receive a stated salary as a director. As of the date of this filing, no director receives any salary or other form of cash compensation for such service. 18 Share Based Compensation. Each non-executive director is entitled to receive annually 70,000 fully-vested stock option grants, 7,000 stock option grants per meeting attended via conference call, 14,000 option grants per meeting attended in person, 3,500 option grants per meeting for participation on a committee or 5,000 stock option grants per meeting for chairing a committee, as compensation for their services as members of our Board of Directors. Effective August 6, 2003, executive directors, including Messrs. Dwight and Tusing are not be compensated separately for their services as members of our Board of Directors. For the twelve month period ending June 30, 2005, Messrs. McDermott, Brown and Segal have earned 189,000, 154,000, and 189,000 stock options, respectively as compensation for their services as members of our Board of Directors. For the twelve month period ending June 30, 2004, Messrs. McDermott, Brown and Segal have earned 243,000, 213,000, and 199,000 stock options, respectively as compensation for their services as members of our Board of Directors. Messrs. Tusing and Dwight have each been granted 5,068 shares of our common stock as compensation for their services as members of our Board of Directors during fiscal 2004. COMPLIANCE WITH SECTION 16(A) OF THE SECURITIES ACT OF 1934 Section 16(a) of the Securities Exchange Act of 1934 requires our directors and executive officers, and persons who own more than 10% of a registered class of our equity securities to file with the Securities and Exchange commission initial reports of ownership and reports of changes in ownership of Common Stock and other of our equity securities. Officers, directors and greater than 10% stockholders are required by SEC regulations to furnish us copies of all Section 16(a) forms they file. To our knowledge, based solely on a review of the copies of such reports furnished to us and written representations that no other reports were required during the fiscal year ended June 30, 2005, all Section 16(a) filing requirements applicable to our officers and directors were complied with. ITEM 10. EXECUTIVE COMPENSATION The following table sets forth compensation for the fiscal year ended June 30, 2005 for our executive officers: SUMMARY COMPENSATION TABLE Annual Compensation Long-Term Compensation ------------------------------------- --- Restricted Securities Name and Other Stock Underlying LTIP All Other Principal Salary Bonus Compensation Awards Options/SARS Payouts Compensation Fiscal Position Year $ $ $ $ # $ $ --------------- ----- --------- ---------- ------------- ----------- -------------- -------- -------------- (a) (b) (c) (d) (e) (f) (g) (h) (i) --------------- ----- --------- ---------- -------------- ----------- -------------- -------- -------------- Daniel R. 2005 180,000 67,500(4) 14,689 -- 750,000 -- -- Dwight, 2004 180,000 -- 14,292 -- 726,206 -- -- President and 2003 180,000 118,800(5) 12,288 -- 660,000 -- -- Chief Executive Officer(1) Richard F. 2005 160,000 37,530(4) -- -- 450,000 -- -- Tusing, Chief 2004 160,000 -- -- -- 971,756 -- -- Operating 2003 80,000 -- -- -- -- -- -- Officer(2) Richard A. 2005 -- -- -- -- -- -- -- Papworth Chief 2004 120,000 -- -- -- -- -- -- Financial 2003 120,000 21,000(5) -- -- 300,000 -- -- Officer(3) (1) Mr. Dwight became President and Chief Executive Officer of Kronos effective October 16, 2001. He executed a two year employment contract on November 15, 2001. His contract was renewed on August 13, 2003 and again on August 15, 2004 and August 15, 2005 by the Board of Directors. His annual salary is $180,000. (2) Mr. Tusing became Chief Operating Officer of Kronos effective January 1, 2002. Mr. Tusing executed an employment contract effective January 1, 2003. The Board of Directors renewed Mr. Tusing's Employment Agreement on October 1, 2004. Prior to this date, Mr. Tusing was compensated as a consultant to the Company. His annual salary is $160,000. 19 (3) Mr. Papworth was the Company's Chief Financial Officer from May 19, 2000 until January 1, 2004. His annual salary was $120,000. On July 1, 2004 Mr. Papworth ended his employment with Kronos. (4) Cash Bonuses earned in 2005 were paid through the issuance of common stock at the market closing price on June 30, 2005. (5) Cash Bonuses earned in 2003 were paid and have been included in Notes Payable. AGGREGATED OPTIONS/SAR EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR END OPTIONS/SAR VALUES(1) VALUE OF NUMBER OF SECURITIES UNEXERCISED UNDERLYING UNEXERCISED IN-THE-MONEY SHARES ACQUIRED OPTIONS/SARS AT FISCAL OPTIONS/SARS AT NAME ON EXERCISE VALUE REALIZED YEAR END(1) FISCAL YEAR END(2) ------------------ ---------------- ---------------- ------------------------- --------------------- Daniel R. Dwight, -0- -0- Exercisable: 4,786,206 -0- President and Unexercisable: -0- -0- Chief Executive Officer(3) Richard F. -0- -0- Exercisable: 2,794,956 -0- Tusing, Chief Unexercisable: -0- -0- Operating Officer(4) Richard A. -0- -0- Exercisable: 1,048,475 -0- Papworth Chief Unexercisable: -0- -0- Financial Officer(5) (1) These grants represent options to purchase common stock. No SAR's have been granted. (2) The value of the unexercised in-the-money options were calculated by determining the difference between the fair market value of the common stock underlying the options and the exercise price of the options as of June 30, 2005. (3) Mr. Dwight became President and Chief Executive Officer of Kronos effective October 16, 2001. (4) Mr. Tusing became Chief Operating Officer of Kronos effective January 1, 2002. (5) Mr. Papworth was the Company's Chief Financial Officer from May 19, 2000 until January 1,

2004. On July 1, 2004 Mr. Papworth ended his employment with Kronos. OPTION/SAR GRANTS IN LAST FISCAL YEAR % TOTAL NO. OF OPTIONS/SAR'S SECURITIES GRANTED TO UNDERLYING EMPLOYEES EXERCISE OR OPTIONS/SAR'S IN FISCAL BASE PRICE NAME GRANTED (#) YEAR (%) ($ PER SHARE) EXPIRATION DATE ------------------- ------------- ------------- ------------ ----------------- Daniel R. Dwight 750,000 43.5% $ 0.125 June 30, 2015 President and Chief Executive Richard F. Tusing 450,000 26.1% $ 0.125 June 30, 2015 Chief Operating Officer 20 STOCK OPTION PLAN On February 12, 2002, the Board of Directors approved the TSET, Inc. Stock Option Plan under which Kronos' key employees, consultants, independent contractors, officers and directors are eligible to receive grants of stock options. Kronos has reserved and issued a total of 6,250,000 shares of common stock under the Stock Option Plan. It is presently administered by Kronos' Board of Directors. Subject to the provisions of the Stock Option Plan, the Board of Directors has full and final authority to select the individuals to whom options will be granted, to grant the options and to determine the terms and conditions and the number of shares issued pursuant thereto. EMPLOYMENT AGREEMENTS Daniel R. Dwight, our President and Chief Executive Officer, and our Company entered into an Employment agreement effective as of November 15, 2001. The initial term of Mr. Dwight's Employment Agreement was for 2 years and will automatically renew for successive 1 year terms unless Kronos or Mr. Dwight provide the other party with written notice within 3 months of the end of the initial term or any subsequent renewal term. The Board of Directors renewed Mr. Dwight's Employment Agreement on August 13, 2003 and again on August 15, 2004 and August 15, 2005. Mr. Dwight's Employment Agreement provides for base cash compensation of $180,000 per year. Mr. Dwight is eligible for annual incentive bonus compensation in an amount equal to Mr. Dwight's annual salary based on the achievement of certain bonus objectives. In addition, Kronos granted Mr. Dwight 1,000,000 immediately vested and exercisable, ten-year stock options at various exercise prices. Mr. Dwight 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. Richard F. Tusing, our Chief Operating Officer, and our Company entered into an Employment agreement effective as of January 1, 2003. The initial term of Mr. Tusing's Employment Agreement is for 2 years and will automatically renew for successive 1 year terms unless Kronos or Mr. Tusing provide the other party with written notice within 3 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. 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. EXECUTIVE SEVERANCE AGREEMENTS The Employment Agreement of Daniel R. Dwight, our Chief Executive Officer, provides that, upon the occurrence of any transaction as defined as a "change of control" of Kronos, Mr. Dwight shall receive his salary and benefits for a period of time that is the greater of (i) one year or (ii) the remainder of Mr. Dwight's employment term. The Employment Agreement of Richard F. Tusing, our Chief Operating Officer, provides that, upon the occurrence of any transaction as defined as a "change of control" of Kronos that is not approved by the Board of Directors, Mr. Tusing shall receive his salary, pro-rata bonus and benefits for a period of time that is the greater of (i) one year or (ii) the remainder of Mr. Tusing's employment term. As of the date of this filing, we have not adopted any separate executive severance agreements. ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT PRINCIPAL STOCKHOLDERS The following table presents certain information regarding the beneficial ownership of all shares of common stock at September 26, 2005 for each executive officer and director of our Company and for each person known to us who owns beneficially more than 5% of the outstanding shares of our common stock. The percentage ownership shown in such table is based upon the 78,030,202 common shares issued and outstanding at September 26, 2005 and ownership by these persons of options or warrants exercisable within 60 days of such date. Also included is beneficial ownership on a fully diluted basis showing all authorized, but unissued, shares of our common stock at September 26, 2005 as issued and outstanding. Unless otherwise indicated, each person has sole voting and investment power over such shares. COMMON STOCK BENEFICIALLY OWNED ------------------------ NAME AND ADDRESS NUMBER PERCENT ---------------- ------------- ----------- Cornell Capital Partners, LP 7,600,000 9.7% 101 Hudson Street - Suite 3700 Jersey City, NJ 07302 Daniel R. Dwight 5,988,132(1) 7.7% 464 Common Street Suite 301 Belmont, MA 02478 21 Richard F. Tusing 3,647,708(2) 4.7% 464 Common Street Suite 301 Belmont, MA 02478 James P. McDermott 797,077(3) 1.0% 464 Common Street Suite 301 Belmont, MA 02478 Milton M. Segal 388,000(4) 0.5% 464 Common Street Suite 301 Belmont, MA 02478 All Officers and Directors of Kronos 18,420,917(5) 23.6% (1) Includes options to purchase 4,786,206 shares of common stock that can be acquired within

sixty days of September 26, 2005. (2) Includes options to purchase 2,794,956 hares of common stock that can be acquired within sixty days of September 26, 2005. (3) Includes options to purchase 502,959 hares of common stock that can be acquired within sixty days of September 26, 2005. (4) Includes options to purchase 388,000 hares of common stock that can be acquired within sixty days of September 26, 2005. (5) Includes options to purchase 8,472,121 shares of common stock that can be acquired within sixty days of September 26, 2005. We are unaware of any arrangement or understanding that may, at a subsequent date, result in a change of control of our Company. ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS We believe that all prior related party transactions have been entered into upon terms no less favorable to us than those that could be obtained from unaffiliated third parties. Our reasonable belief of fair value is based upon proximate similar transactions with third parties or attempts to obtain the consideration from third parties. All ongoing and future transactions with such persons, including any loans or compensation to such persons, will be approved by a majority of disinterested members of the Board of Directors. On March 31, 2004, we entered into Promissory Notes with Daniel R. Dwight and Richard F. Tusing in exchange for past due compensation, expenses and interest do and payable for $363,139 and $485,883. The Notes bear a simple interest rate 1% per month and call for aggregate monthly principal and interest payments $6,718 and $8,989, respectively, for each month in which the Company's beginning cash balance equals or exceeds $200,000. Subject to certain conditions, including default, these notes become payable in full. In the event of a debt or equity financing, 20% of the proceeds derived from the financing will be used to pay down the outstanding interest and principal obligations. As a result of the Cornell Capital financing, the Notes are due and payable in full. As of June 30, 2005, $679,000 had been paid under the terms of the Notes. ITEM 13. EXHIBITS (a)(3) EXHIBITS. EXHIBIT NO. DESCRIPTION LOCATION
--- 2.1 Articles of Merger for Technology Incorporated by reference to Selection, Inc. with the Nevada Exhibit 2.1 to the Registrant's Secretary of State Registration Statement on Form S-1 filed on August 7, 2001 (the "Registration Statement") 3.1 Articles of Incorporation Incorporated by reference to Exhibit 3.1 to the Registration Statement on Form S-1 filed on August 7, 2001 3.2 Bylaws Incorporated by reference to Exhibit 3.2 to the Registration Statement on Form S-1 filed on August 7, 2001 4.1 2001 Stock Option Plan Incorporated by reference to Exhibit 4.1 to Registrant's Form 10-Q for the quarterly period ended March 31, 2002 filed on May 15, 2002 22 10.21 Indemnification Agreement, dated May 1, Incorporated by reference to 2001, by and between TSET, Inc. and Exhibit 10.38 to the Daniel R. Dwight Registration Statement on Form S-1 filed on August 7, 2001 10.22 Indemnification Agreement, dated May 1, Incorporated by reference to 2001, by and between TSET, Inc. and Exhibit 10.39 to the Richard F. Tusing Registration Statement on Form S-1 filed on August 7, 2001 10.23 Employment Agreement, effective Incorporated by reference to February 11, 2001 by and between Exhibit 10.55 to the Registrant's TSET, Inc. and Daniel R. Dwight Form 10-Q for the quarterly period ended March 31, 2002 filed on May 15, 2002 10.24 Common Stock Purchase Agreement, Incorporate by reference to Exhibit dated August 12, 2002 by and between 10.57 to the Registrant's Form S-1 between TSET, Inc. and Fusion filed on August 13, 2002 Capital Fund II, LLC 10.25 Registration Rights Agreement, dated Incorporated by reference to Exhibit August 12, 2002 by and between TSET, 10.58 to the Registrant's Form S-1 Inc. and Fusion Capital Fund II, LLC filed on August 13, 2002 10.26 Termination Agreement, dated Incorporated by reference to Exhibit August 12, 2002 by and between TSET, 10.59 to the Registrant's Amendment Inc. and Fusion Capital Fund II, LLC No. 1 to Form S-1 filed on September 16, 2002 10.27 Master Loan and Investment Incorporated by reference to Agreement, dated May 9, 2003, the Registrant's 8-K filed on by and among Kronos Advanced May 15, 2003 Technologies, Inc., Kronos Air Technologies, Inc. and FKA Distributing Co. d/b/a HoMedics, Inc., a Michigan corporation ("HoMedics") 10.28 Secured Promissory Note, dated Incorporated by reference to May 9, 2003, in the principal Exhibit 99.2 to the Registrant's amount of $2,400,000 payable to 8-K filed on May 15, 2003 HoMedics 10.29 Secured Promissory Note, dated Incorporated by reference to May 9, 2003, in the principal Exhibit 99.4 to the Registrant's amount of $1,000,000 payable to 8-K filed on May 15, 2003 HoMedics 10.30 Security Agreement dated May 9, Incorporated by reference to 2003, by and among Kronos Air Exhibit 99.4 to the Registrant's Technologies, Inc. and HoMedics 8-K filed on May 15, 2003 10.31 Registration Rights Agreement, Incorporated by reference to dated May 9, 2003, by and between Exhibit 99.5 to the Registrant's Kronos and HoMedics 8-K filed on May 15, 2003 10.32 Warrant No. 1 dated May 9, 2003, Incorporated by reference to issued to HoMedics Exhibit 99.7 to the Registrant's 8-K filed on May 15, 2003 10.33 Warrant No. 2 dated May 9, 2003, Incorporated by reference to issued to HoMedics Exhibit 99.7 to the Registrant's 8-K filed on May 15, 2003 2002 23 10.33 Consulting Agreement effective

Incorporated by reference to October 31, 2003, by and among Kronos Exhibit 10.67 to the Registrant's Advanced Technologies, Inc., Form 10-Q for the quarterly period Steven G. Martin and Joshua B. on ended December 31, 2003 filed on Scheinfeld February 17, 2004 10.34 Promissory Note by and among Kronos Incorporated by reference to Advanced Technologies, Inc., and Exhibit 10.67 to the Registrant's Richard A. Papworth Form 10-Q for the quarterly period ended March 31, 2004 filed on May 17, 2004 10.35 Promissory Note by and among Kronos Incorporated by reference to Advanced Technologies, Inc., and Exhibit 10.67 to the Registrant's Daniel R. Dwight Form 10-Q for the quarterly period ended March 31, 2004 filed on May 17, 2004 10.36 Promissory Note by and among Kronos Incorporated by reference to Advanced Technologies, Inc., and Exhibit 10.67 to the Registrant's Richard F. Tusing Form 10-Q for the quarterly period ended March 31, 2004 filed on May 17, 2004 10.37 Promissory Note by and among Kronos Incorporated by reference to Advanced Technologies, Inc., and Exhibit 10.67 to the Registrant's Igor Krichtafovitch Form 10-Q for the quarterly period ended March 31, 2004 filed on May 17, 2004 10.38 Promissory Note by and among Kronos Incorporated by reference to Advanced Technologies, Inc., and Exhibit 10.67 to the Registrant's J. Alexander Chriss Form 10-Q for the quarterly period ended March 31, 2004 filed on May 17, 2004 10.39 Standby Equity Distribution Agreement, Incorporated by reference to dated October 15, 2004, by and between Exhibit 99.1 to the Registrant's Kronos Advanced Technologies, Inc. and Form 8-K filed on February 12, 2004 Cornell Capital Partners, LP 10.40 Registration Rights Agreement, dated Incorporated by reference to October 15, 2004, by and between Kronos Exhibit 99.2 to the Registrant's Advanced Technologies, Inc. and Cornell Form 8-K filed on February 12, 2004 Capital Partners, LP 10.41 Escrow Agreement, dated October 15, 2004, Incorporated by reference to by and between Kronos Advanced Exhibit 99.3 to the Registrant's Technologies, Inc. and Cornell Capital Form 8-K filed on February 12, 2004 Partners, LP 10.42 Placement Agent Agreement, dated October Incorporated by reference to 15, 2004, by and between Kronos Advanced Exhibit 99.4 to the Registrant's Technologies, Inc. and Cornell Capital Form 8-K filed on February 12, 2004 Partners, LP 10.43 Securities Purchase Agreement, dated Incorporated by reference to October 15, 2004, by and between Kronos Exhibit 99.5 to the Registrant's Advanced Technologies, Inc. and Cornell Form 8-K filed on February 12, 2004 Capital Partners, LP 10.44 Investor Registration Rights Agreement, Incorporated by reference to dated October 15, 2004, by and between Exhibit 99.6 to the Registrant's Kronos Advanced Technologies, Inc. and Form 8-K filed on February 12, 2004 Cornell Capital Partners, LP 10.45 Escrow Agreement, dated October 15, 2004, Incorporated by reference to by and between Kronos Advanced Exhibit 99.7 to the Registrant's Technologies, Inc. and Cornell Capital Form 8-K filed on February 12, 2004 Partners, LP 24 10.46 Form of Equity-Back Promissory Note in Incorporated by reference to the principal amount of $2,000,000 Exhibit 99.8 to the Registrant's Form 8-K filed on February 12, 2004 10.47 First Amendment to Master Loan and Incorporated by reference to Investment Agreement, dated October 25, Exhibit 99.9 to the Registrant's 2004, by and among Kronos Advanced Form 8-K filed on February 12, 2004 Technologies, Inc., f/k/a TSET, Inc., a Nevada corporation, Kronos Air Technologies, Inc., a Nevada corporation and FKA Distributing Co. d/b/a HoMedics, Inc., a Michigan corporation 10.48 Secured Promissory Note, dated October Incorporated by reference to 25, 2004, payable to FKA Distributing Exhibit 99.10 to the Registrant's Co., d/b/a HoMedics, Inc., a Michigan Form 8-K filed on February 12, 2004 corporation, in the principal amount of $925,000 10.49 Amended and Restated Warrant No. 1, Incorporated by reference to dated October 25, 2004, issued to FKA Exhibit 99.11 to the Registrant's Distributing Co. d/b/a HoMedics, Inc. Form 8-K filed on February 12, 2004 10.50 Amended and Restated Warrant No. 2, Incorporated by reference to dated October 25, 2004, issued to FKA Exhibit 99.12 to the Registrant's Distributing Co. d/b/a HoMedics, Inc. Form 8-K filed on February 12, 2004 10.51 Warrant No. 3, dated October 25, 2004, Incorporated by reference to issued to FKA Distributing Co. d/b/a Exhibit 99.13 to the Registrant's HoMedics, Inc. Form 8-K filed on February 12, 2004 10.52 Amended and Restated Registration Rights Incorporated by reference to Agreement, dated October 25, 2004, by Exhibit 99.14 to the Registrant's And between Kronos Advanced Form 8-K filed on February 12, 2004 Technologies Inc., a Nevada corporation and FKA Distributing Co. d/b/a HoMedics, a Michigan corporation 10.53 Termination Agreement dated March 28, Incorporated by reference to Exhibit 2005, by and between Kronos Advanced 10.63 to the Registrant's Form SB-2 Technologies, Inc. and Cornell Capital filed on April 19, 2005 Partners, LP 10.54 Standby Equity Distribution Agreement, Incorporated by reference to Exhibit dated April 13, 2005, by and between 10.64 to the Registrant's Form SB-2 Kronos Advanced Technologies, Inc. and filed on April 19, 2005 Cornell Capital Partners, LP 10.55 Registration Rights Agreement, dated Incorporated by reference to Exhibit April 13, 2005, by and between Kronos 10.65 to the Registrant's Form SB-2 Advanced Technologies, Inc. and Cornell filed on April 19, 2005 Capital Partners, LP 10.56 Escrow Agreement, dated April 13, 2005, Incorporated by reference to

Exhibit by and between Kronos Advanced 10.66 to the Registrant's Form SB-2 Technologies, Inc. and Cornell Capital filed on April 19, 2005 Partners, LP 10.57 Placement Agent Agreement, dated April Incorporated by reference to Exhibit 13, 2005, by and between Kronos Advanced 10.67 to the Registrant's Form SB-2 Technologies, Inc. and Cornell Capital filed on April 19, 2005 Partners, LP 25 10.58 Form of Equity-Back Promissory Note in Incorporated by reference to Exhibit the principal amount of $2,000,000 dated 10.68 to the Registrant's Form SB-2 March 7, 2005 between Kronos Advanced filed on April 19, 2005 Technologies, Inc. and Cornell Capital Partners, LP 10.59 Form of Equity-Back Promissory Note in Provided herewith the principal amount of $2,000,000 dated June 22, 2005 between Kronos Advanced Technologies, Inc. and Cornell Capital Partners, LP EXHIBIT NO. DESCRIPTION LOCATION -- 31.1 Certification of Chief Executive Provided herewith Officer pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 31.2 Certification of Principal Financial Provided herewith Officer pursuant to U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 32.1 Certification by Chief Executive Officer Provided herewith and Principal Accounting Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 ITEM 14. PRINCIPAL ACCOUNTANT AND SERVICES The firm Sherb & Co. LLP, independent registered public accounting firm, has audited our financial statements for the year ended June 30, 2005. The Board of Directors has appointed Sherb & Co. LLP to serve as our independent registered public accounting firm for the 2004 year-end audit and to review our quarterly financial reports for filing with the Securities and Exchange Commission during fiscal year 2005. The following table shows the fees paid or accrued by us for the audit and other services provided by Sherb & Co. LLP for fiscal year 2005 and 2004. June 30, 2005 June 30, 2004 -------------- -------------- Audit Fees(1) $ 62,500 $ 61,000 Audit-Related Fees 14,165 1,710 -------------- -------------- Total $ 76,665 $ 62,710 =============== =============== (1) Audit fees represent fees for professional services provided in connection with the audit of our annual financial statements and review of our quarterly financial statements and audit services provided in connection with other statutory or regulatory filings 26 SIGNATURES Pursuant to the requirements of Sections 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereto duly authorized. Date: September 28, 2005. KRONOS ADVANCED TECHNOLOGIES, INC. By: /s/ Daniel R. Dwight ----------------------------------- Daniel R. Dwight President, Chief Executive Officer and Director By: /s/ Daniel R. Dwight ----------------------------------- Daniel R. Dwight Acting Chief Financial Officer and Director Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated. SIGNATURE TITLE DATE --------- ----- ---- /s/ Daniel R. Dwight ---------------------------- Daniel R. Dwight Director, President, September 28, 2005 Chief Executive Officer and Acting Chief Financial Officer /s/ James P. McDermott ---------------------------- James P. McDermott Director September 28, 2005 /s/ M. J. Segal ---------------------------- M. J. Segal Director September 28, 2005 /s/ Richard F. Tusing ---------------------------- Richard F. Tusing Director and Chief September 28, 2005 Operating Officer