

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

FORM 10-Q

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

For the quarterly period ended June 30, 2008

or

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

For the transition period from _____ to _____

Commission File Number 0-29185

SAVE THE WORLD AIR, INC.

(Exact name of registrant as specified in its charter)

Nevada
*(State or other jurisdiction of
incorporation or organization)*

52-2088326
*(I.R.S. Employer
Identification No.)*

235 Tennant Avenue
Morgan Hill, California 95037
(Address, including zip code, of principal executive offices)
(408) 778-0101
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Exchange Act: None.

Securities registered pursuant to Section 12(g) of the Exchange Act: Common Stock, \$0.001 par value.

Check whether the Registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

The number of shares of the Registrant's Common Stock outstanding as of August 8, 2008 was 55,751,669 shares.

SAVE THE WORLD AIR, INC.
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PART I

Item 1. Financial Statements

**SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)**

**CONDENSED CONSOLIDATED BALANCE SHEETS
JUNE 30, 2008 (UNAUDITED) AND DECEMBER 31, 2007**

	June 30, 2008 (unaudited)	December 31, 2007
ASSETS		
Current assets		
Cash	\$ 78,187	\$ 47,660
Accounts receivable, net of allowance for doubtful accounts of \$1,380 and \$0, respectively	-	1,380
Inventory	30,256	30,256
Other current assets	<u>36,422</u>	<u>20,552</u>
Total current assets	<u>144,865</u>	<u>99,848</u>
Equipment, net	154,796	201,058
Other assets	<u>11,250</u>	<u>4,500</u>
Total assets	<u>\$ 310,911</u>	<u>\$ 305,406</u>
LIABILITIES AND STOCKHOLDERS' DEFICIENCY		
Current liabilities		
Accounts payable-related parties	\$ 289,718	\$ 323,413
Accounts payable-other	966,186	244,224
Accrued expenses	724,151	742,719
Accrued research and development fees	33,347	53,347
Accrued professional fees	265,431	747,261
Loan payable-related party	86,038	83,596
Loans and other payable due to Morale/Matthews	—	1,748,452
Convertible debentures, net-related parties	185,134	227,136
Convertible debentures, net-others	<u>274,570</u>	<u>495,044</u>
Total current liabilities	<u>2,824,575</u>	<u>4,665,192</u>
Commitments and contingencies		
Stockholders' deficiency		
Common stock, \$.001 par value: 200,000,000 shares authorized, 57,751,669 and 46,470,413 shares issued and outstanding at June 30, 2008 and December 31, 2007, respectively	57,753	46,471
Common stock to be issued	—	4,000
Additional paid-in capital	37,094,797	32,280,083
Deficit accumulated during the development stage	<u>(39,666,214)</u>	<u>(36,690,340)</u>
Total stockholders' deficiency	<u>(2,513,664)</u>	<u>(4,359,786)</u>
Total liabilities and stockholders' deficiency	<u>\$ 310,911</u>	<u>\$ 305,406</u>

See notes to condensed consolidated financial statements.

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three months ended		Six months ended		For the
	June 30,		June 30,		Period From
	2008	2007	2008	2007	February 18,
					1998 (Date
					of Inception)
					through
					June 30,
					2008
Net sales	\$ -	\$ -	\$ -	\$ 22,000	\$ 69,000
Cost of goods sold	-	-	-	5,360	24,120
Gross profit	-	-	-	16,640	44,880
Operating expenses	(519,860)	(1,023,787)	(1,280,002)	(2,303,562)	(28,139,323)
Research and development expenses	(62,692)	(100,731)	(322,362)	(441,183)	(5,128,592)
Non-cash patent settlement costs	-	-	-	-	(1,610,066)
Loss before other income (expense)	(582,552)	(1,124,518)	(1,602,364)	(2,728,105)	(34,833,101)
Other income (expense)					
Other income	11	90	563	177	4,072
Interest income	-	33	2	50	16,344
Interest expense	(161,556)	(403,788)	(1,416,462)	(713,666)	(5,908,842)
Loss on sale of equipment	-	-	(9,683)	-	(9,683)
Settlement of litigation and debt	52,070	-	52,070	-	1,069,278
Loss before provision for income taxes	(692,027)	(1,528,183)	(2,975,874)	(3,441,544)	(39,661,932)
Provision for income taxes	-	-	0	(800)	(4,282)
Net loss	<u>\$ (692,027)</u>	<u>\$ (1,528,183)</u>	<u>\$ (2,975,874)</u>	<u>\$ (3,442,344)</u>	<u>\$ (39,666,214)</u>
Net loss per share, basic and diluted	<u>\$ (0.02)</u>	<u>\$ (0.04)</u>	<u>\$ (0.06)</u>	<u>\$ (0.09)</u>	
Weighted average shares outstanding, basic and diluted	<u>44,938,165</u>	<u>39,746,015</u>	<u>46,979,175</u>	<u>37,297,407</u>	

See notes to condensed consolidated financial statements.

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per <u>Share</u>	<u>Common Stock</u>		<u>Common Stock to be Issued</u>	<u>Additional Paid-in Capital</u>	<u>Deferred Compensation</u>	<u>Deficit Accumulated During the Development Stage</u>	<u>Total Stockholders' Deficiency</u>
		<u>Shares</u>	<u>Amount</u>					
Balance, February 18, 1998 (date of inception)		—	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Issuance of common stock on April 18, 1998	.0015 — .01	10,030,000	10,030	—	14,270	—	—	24,300
Net loss		—	—	—	—	—	(21,307)	(21,307)
Balance, December 31, 1998		10,030,000	\$ 10,030	\$ —	14,270	\$ —	\$ (21,307)	\$ 2,993
Issuance of common stock on May 18, 1999	1.00 — 6.40	198,003	198	—	516,738	—	—	516,936
Issuance of common stock for ZEFS on September 14, 1999	.001	5,000,000	5,000	—	—	—	—	5,000
Stock issued for professional services on May 18, 1999	0.88	69,122	69	—	49,444	—	—	49,513
Net loss		—	—	—	—	—	(1,075,264)	(1,075,264)
Balance, December 31, 1999		15,297,125	\$ 15,297	\$ —	\$ 580,452	\$ —	\$ (1,096,571)	\$ (500,822)
Stock issued for employee compensation on February 8, 2000	1.03	20,000	20	—	20,580	—	—	20,600
Stock issued for consulting services on February 8, 2000	1.03	100,000	100	—	102,900	—	—	103,000
Stock issued for professional services on April 18, 2000	3.38	27,000	27	—	91,233	—	—	91,260
Stock issued for directors fees on April 18, 2000	3.38	50,000	50	—	168,950	—	—	169,000
Stock issued for professional services on May 19, 2000	4.06	5,000	5	—	20,295	—	—	20,300
Stock issued for directors fees on June 20, 2000	4.44	6,000	6	—	26,634	—	—	26,640
Stock issued for professional services on June 20, 2000	4.44	1,633	2	—	7,249	—	—	7,251

(continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per <u>Share</u>	<u>Common Stock</u>		Common Stock to be <u>Issued</u>	Additional Paid-in <u>Capital</u>	Deferred <u>Compensation</u>	Deficit Accumulated During the Development <u>Stage</u>	Total Stockholders' <u>Deficiency</u>
		<u>Shares</u>	<u>Amount</u>					
Stock issued for professional services on June 26, 2000	5.31	1,257	1	—	6,674	—	—	6,675
Stock issued for employee compensation on June 26, 2000	5.31	22,000	22	—	116,798	—	—	116,820
Stock issued for consulting services on June 26, 2000	5.31	9,833	10	—	52,203	—	—	52,213
Stock issued for promotional services on July 28, 2000	4.88	9,675	9	—	47,205	—	—	47,214
Stock issued for consulting services on July 28, 2000	4.88	9,833	10	—	47,975	—	—	47,985
Stock issued for consulting services on August 4, 2000	2.13	35,033	35	—	74,585	—	—	74,620
Stock issued for promotional services on August 16, 2000	2.25	25,000	25	—	56,225	—	—	56,250
Stock issued for consulting services on September 5, 2000	2.25	12,833	13	—	28,861	—	—	28,874
Stock issued for consulting services on September 10, 2000	1.50	9,833	10	—	14,740	—	—	14,750
Stock issued for consulting services on November 2, 2000	0.88	9,833	10	—	8,643	—	—	8,653
Stock issued for consulting services on November 4, 2000	0.88	9,833	10	—	8,643	—	—	8,653

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per <u>Share</u>	<u>Common Stock</u>		Common Stock to be Issued	Additional Paid-in Capital	Deferred Compensation	Deficit Accumulated During the Development Stage	Total Stockholders' Deficiency
		<u>Shares</u>	<u>Amount</u>					
Stock issued for consulting services on December 20, 2000	0.50	19,082	19	—	9,522	—	—	9,541
Stock issued for filing services on December 20, 2000	0.50	5,172	5	—	2,581	—	—	2,586
Stock issued for professional services on December 26, 2000	0.38	12,960	13	—	4,912	—	—	4,925
Other stock issuance on August 24, 2000	2.13	2,000	2	—	4,258	—	—	4,260
Common shares cancelled		(55,000)	(55)	—	(64,245)	—	—	(64,300)
Net loss		—	—	—	—	—	(1,270,762)	(1,270,762)
Balance, December 31, 2000		15,645,935	\$ 15,646	\$ —	\$ 1,437,873	\$ —	\$ (2,367,333)	\$ (913,814)
Stock issued for consulting services on January 8, 2001	0.31	9,833	10	—	3,038	—	—	3,048
Stock issued for consulting services on February 1, 2001	0.33	9,833	10	—	3,235	—	—	3,245
Stock issued for consulting services on March 1, 2001	0.28	9,833	10	—	2,743	—	—	2,753

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SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per <u>Share</u>	<u>Common Stock</u>		Common Stock to be Issued	Additional Paid-in Capital	Deferred Compensation	Deficit Accumulated	
		<u>Shares</u>	<u>Amount</u>				During the Development Stage	Total Stockholders' Deficiency
Stock issued for legal services on March 13, 2001	0.32	150,000	150	—	47,850	—	—	48,000
Stock issued for consulting services on April 3, 2001	0.25	9,833	10	—	2,448	—	—	2,458
Stock issued for legal services on April 4, 2001	0.25	30,918	31	—	7,699	—	—	7,730
Stock issued for professional services on April 4, 2001	0.25	7,040	7	—	1,753	—	—	1,760
Stock issued for consulting services on April 5, 2001	0.25	132,600	132	—	33,018	—	—	33,150
Stock issued for filing fees on April 30, 2001	1.65	1,233	1	—	2,033	—	—	2,034
Stock issued for filing fees on September 19, 2001	0.85	2,678	2	—	2,274	—	—	2,276
Stock issued for professional services on September 28, 2001	0.62	150,000	150	—	92,850	—	—	93,000
Stock issued for directors services on October 5, 2001	0.60	100,000	100	—	59,900	—	—	60,000
Stock issued for legal services on October 17, 2001	0.60	11,111	11	—	6,655	—	—	6,666

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SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per <u>Share</u>	<u>Common Stock</u>		Common Stock to be Issued	Additional Paid-in Capital	Deferred Compensation	Deficit Accumulated During the Development Stage	Total Stockholders' Deficiency
		Shares	Amount					
Stock issued for consulting services on October 18, 2001	0.95	400,000	400	—	379,600	—	—	380,000
Stock issued for consulting services on October 19, 2001	1.25	150,000	150	—	187,350	—	—	187,500
Stock issued for exhibit fees on October 22, 2001	1.35	5,000	6	—	6,745	—	—	6,751
Stock issued for directors	0.95	1,000,000	1,000	—	949,000	—	—	950,000
Stock issued for consulting services on November 7, 2001	0.85	20,000	20	—	16,980	—	—	17,000
Stock issued for consulting services on November 20, 2001	0.98	43,000	43	—	42,097	—	—	42,140
Stock issued for consulting services on November 27, 2001	0.98	10,000	10	—	9,790	—	—	9,800
Stock issued for consulting services on November 28, 2001	0.98	187,000	187	—	183,073	—	—	183,260
Intrinsic value of options issued to employees		—	—	—	2,600,000	(2,600,000)	—	—
Fair value of options issued to non-employees for services		—	—	—	142,318	—	—	142,318

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per <u>Share</u>	<u>Common Stock</u>		Common Stock to be Issued	Additional Paid-in Capital	Deferred Compensation	Deficit Accumulated	
		<u>Shares</u>	<u>Amount</u>				<u>During the Development Stage</u>	<u>Total Stockholders' Deficiency</u>
Amortization of deferred compensation		—	—	—	—	191,667	—	191,667
Net loss		—	—	—	—	—	(2,735,013)	(2,735,013)
Balance, December 31, 2001		18,085,847	\$ 18,086	\$ —	\$ 6,220,322	\$ (2,408,333)	\$ (5,102,346)	\$ (1,272,271)
Stock issued for directors services on December 10, 2002	0.40	2,150,000	2,150	—	857,850	—	—	860,000
Common stock paid for, but not issued (2,305,000 shares)	0.15-0.25	—	—	389,875	—	—	—	389,875
Fair value of options issued to non-employees for services		—	—	—	54,909	(54,909)	—	—
Amortization of deferred compensation		—	—	—	—	891,182	—	891,182
Net loss for the year ended December 31, 2002		—	—	—	—	—	(2,749,199)	(2,749,199)
Balance, December 31, 2002		20,235,847	\$ 20,236	\$ 389,875	\$ 7,133,081	\$ (1,572,060)	\$ (7,851,545)	\$ (1,880,413)
Common stock issued, previously paid for	0.15	1,425,000	1,425	(213,750)	212,325	—	—	—
Common stock issued, previously paid for	0.25	880,000	880	(220,000)	219,120	—	—	—
Stock issued for cash on March 20, 2003	0.25	670,000	670	—	166,830	—	—	167,500
Stock issued for cash on April 4, 2003	0.25	900,000	900	—	224,062	—	—	224,962
Stock issued for cash on April 8, 2003	0.25	100,000	100	—	24,900	—	—	25,000
Stock issued for cash on May 8, 2003	0.25	1,150,000	1,150	—	286,330	—	—	287,480
Stock issued for cash on June 16, 2003	0.25	475,000	475	—	118,275	—	—	118,750

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per <u>Share</u>	<u>Common Stock</u>		Common Stock to be <u>Issued</u>	Additional Paid-in <u>Capital</u>	Deferred <u>Compensation</u>	Deficit Accumulated During the Development <u>Stage</u>	Total Stockholders' <u>Deficiency</u>
		<u>Shares</u>	<u>Amount</u>					
Stock issued for cash on June 16, 2003	0.25	475,000	475	—	118,275	—	—	118,750
Stock issued for legal services on June 27, 2003	0.55	83,414	83	—	45,794	—	—	45,877
Debt converted to stock on June 27, 2003	0.25	2,000,000	2,000	—	498,000	—	—	500,000
Stock and warrants issued for cash on July 11, 2003	0.25	519,000	519	—	129,231	—	—	129,750
Stock and warrants issued for cash on September 29, 2003	0.25	1,775,000	1,775	—	441,976	—	—	443,751
Stock and warrants issued for cash on October 21, 2003	0.25	1,845,000	1,845	—	459,405	—	—	461,250
Stock and warrants issued for cash on October 28, 2003	0.25	1,570,000	1,570	—	390,930	—	—	392,500
Stock and warrants issued for cash on November 19, 2003	0.25	500,000	500	—	124,500	—	—	125,000
Finders' fee related to stock issuances		—	—	43,875	(312,582)	—	—	(268,707)
Common stock paid for, but not issued (25,000 shares)	0.25	—	—	6,250	—	—	—	6,250
Amortization of deferred comp		—	—	—	—	863,727	—	863,727
Net loss for year ended December 31, 2003		—	—	—	—	—	(2,476,063)	(2,476,063)
Balance, December 31, 2003		34,128,261	\$ 34,128	\$ 6,250	\$10,162,177	\$ (708,333)	\$ (10,327,608)	\$ (833,386)

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per <u>Share</u>	<u>Common Stock</u>		Common Stock to be <u>Issued</u>	Additional Paid-in <u>Capital</u>	Deferred <u>Compensation</u>	Deficit Accumulated During the Development <u>Stage</u>	Total Stockholders' <u>Deficiency</u>
		<u>Shares</u>	<u>Amount</u>					
Common stock issued, previously paid for	0.25	25,000	25	(6,250)	6,225	—	—	—
Stock issued for director services on March 31, 2004	1.50	50,000	50	—	74,950	—	—	75,000
Stock issued for finders fees on March 31, 2004	0.15	82,500	82	—	12,293	—	—	12,375
Stock issued for finders fees on March 31, 2004	0.25	406,060	407	—	101,199	—	—	101,606
Stock issued for services on April 2, 2004	1.53	65,000	65	—	99,385	—	—	99,450
Debt converted to stock on April 2, 2004	1.53	60,000	60	—	91,740	—	—	91,800
Stock issued upon exercise of warrants on May 21, 2004	0.20	950,000	950	—	189,050	—	—	190,000
Stock issued for directors services on June 8, 2004	1.70	600,000	600	—	1,019,400	—	—	1,020,000
Stock issued for cash on August 25, 2004	1.00	550,000	550	—	549,450	—	—	550,000
Stock issued upon exercise of options on August 30, 2004	0.40	4,000	4	—	1,596	—	—	1,600
Stock issued for cash on September 8, 2004	1.00	25,000	25	—	24,975	—	—	25,000
Stock issued for consulting services on September 15, 2004	1.31	50,000	49	—	65,451	—	—	65,500

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	<u>Price per</u>	<u>Common Stock</u>		<u>Common</u>	<u>Additional</u>	<u>Deferred</u>	<u>Deficit</u>	<u>Total</u>
	<u>Share</u>	<u>Shares</u>	<u>Amount</u>	<u>Stock</u>	<u>Paid-in</u>	<u>Compensation</u>	<u>Accumulated</u>	<u>Stockholders'</u>
				<u>to be</u>	<u>Capital</u>		<u>During the</u>	<u>Deficiency</u>
				<u>Issued</u>			<u>Development</u>	
							<u>Stage</u>	
Stock issued for patent settlement on September 22, 2004	1.24	20,000	20	—	24,780	—	—	24,800
Stock issued for research and development on October 6, 2004	1.40	65,000	65	—	90,935	—	—	91,000
Stock issued for cash on October 6, 2004	1.00	25,000	25	—	24,975	—	—	25,000
Stock issued for cash on October 15, 2004	1.00	150,000	150	—	149,850	—	—	150,000
Stock issued upon exercise of stock options on October 21, 2004	0.40	6,500	6	—	2,594	—	—	2,600
Stock issued for cash on November 3, 2004	1.00	25,000	25	—	24,975	—	—	25,000
Stock issued for cash on November 18, 2004	1.00	172,500	173	—	172,327	—	—	172,500
Stock issued for cash on December 9, 2004	1.00	75,000	75	—	74,925	—	—	75,000
Stock issued for cash on December 23, 2004	1.00	250,000	250	—	249,750	—	—	250,000
Finders fees related to stock issuances	—	—	—	—	(88,384)	—	—	(88,384)
Common stock paid for, but not issued (119,000 shares)	—	—	—	119,000	—	—	—	119,000

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per <u>Share</u>	<u>Common Stock</u>		Common Stock to be Issued	Additional Paid-in Capital	Deferred Compensation	Deficit Accumulated During the Development Stage	Total Stockholders' Deficiency	
		<u>Shares</u>	<u>Amount</u>						
Intrinsic value of options issued to employees	—	—	—	—	—	248,891	(248,891)	—	—
Fair value of options issued to non-employees for services	—	—	—	—	—	55,381	(55,381)	—	—
Fair value of warrants issued for settlement costs	—	—	—	—	—	1,585,266	—	—	1,585,266
Fair value of warrants issued to non-employees for services	—	—	—	—	—	28,872	—	—	28,872
Amortization of deferred compensation	—	—	—	—	—	—	936,537	—	936,537
Net loss for year ended December 31, 2004	—	—	—	—	—	—	—	(6,803,280)	(6,803,280)
Balance, December 31, 2004			37,784,821	\$ 37,784	\$ 119,000	\$ 15,043,028	\$ (76,068)	\$(17,130,888)	\$(2,007,144)
Common stock issued, previously paid for	1.00	69,000	69	(69,000)	68,931	—	—	—	—
Stock issued upon exercise of warrants, previously paid for	1.00	50,000	50	(50,000)	49,950	—	—	—	—

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per Share	Common Stock		Common Stock to be Issued	Additional Paid-in Capital	Deferred Compensation	Deficit Accumulated During the Development Stage	Total Stockholders' Deficiency
		Shares	Amount					
Stock issued for cash on January 20, 2005	1.00	25,000	25	—	24,975	—	—	25,000
Stock issued upon exercise of warrants on January 31, 2005	0.40	500	1	—	199	—	—	200
Stock issued for cash on February 17, 2005	1.00	325,000	325	—	324,675	—	—	325,000
Stock issued for cash on March 31, 2005	1.00	215,000	215	—	214,785	—	—	215,000
Stock issued for cash on May 17, 2005	1.00	5,000	5	—	4,995	—	—	5,000
Stock issued for cash on June 7, 2005	1.00	300,000	300	—	299,700	—	—	300,000
Stock issued for cash on August 5, 2005	1.00	480,500	480	—	480,020	—	—	480,500
Stock issued for cash on August 9, 2005	1.00	100,000	100	—	99,900	—	—	100,000
Stock issued for cash on October 27, 2005	1.00	80,000	80	—	79,920	—	—	80,000
Common stock cancelled on December 7, 2005	Various	(8,047,403)	(8,047)	—	8,047	—	—	—
Stock to be issued for settlement of payables on December 21, 2005	—	—	—	57,092	—	—	—	57,092

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price	Common Stock		Common	Additional	Deferred	Deficit	Total
	per	Shares	Amount	Stock	Paid-in	Compensation	Accumulated	Stockholders'
	Share			to be	Capital		During the	Deficiency
				Issued			Development	
							Stage	
Stock to be issued for settlement of payables on December 31, 2005	—	—	—	555,429	—	—	—	555,429
Finders fees related to stock issuances	—	—	—	—	(109,840)	—	—	(109,840)
Intrinsic value of options issued to employees	—	—	—	—	243,750	(243,750)	—	—
Fair value of options issued for settlement costs	—	—	—	—	31,500	—	—	31,500
Fair value of warrants issued for settlement costs	—	—	—	—	4,957	—	—	4,957
Fair value of warrants issued to non-employees for services	—	—	—	—	13,505	—	—	13,505
Amortization of deferred compensation	—	—	—	—	—	177,631	—	177,631
Warrants issued with convertible notes	—	—	—	—	696,413	—	—	696,413
Intrinsic value of beneficial conversion associated with convertible notes	—	—	—	—	756,768	—	—	756,768

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price	Common Stock		Common	Additional	Deferred	Deficit	Total
	per			Stock	Paid-in		Accumulated	Stockholders'
	Share	Shares	Amount	to be	Capital	Compensation	During the	Deficiency
				Issued			Development	
							Stage	
Net loss for year ended December 31, 2005	—	—	—	—	—	—	(3,115,186)	(3,115,186)
Balance, December 31, 2005		31,387,418	\$ 31,387	\$ 612,521	\$18,336,178	\$ (142,187)	\$ (20,246,074)	\$ (1,408,175)
Stock issued, for previously settled payables	—	846,549	847	(612,521)	611,674	—	—	—
Stock issued upon exercise of warrants on March 23, 2006	1.50	25,000	25	—	37,475	—	—	37,500
Stock issued upon exercise of warrants on March 27, 2006	1.50	50,000	50	—	74,950	—	—	75,000
Stock issued upon exercise of warrants on March 27, 2006	0.50	25,000	25	—	12,475	—	—	12,500
Stock issued upon exercise of warrants on March 30, 2006	1.00	10,000	10	—	9,990	—	—	10,000
Stock issued upon exercise of warrants on April 10, 2006	0.50	36,250	36	—	18,089	—	—	18,125
Common stock issued for convertible debt on April 10, 2006	0.70	269,600	270	—	188,450	—	—	188,720

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
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CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per <u>Share</u>	<u>Common Stock</u>		Common Stock to be Issued	Additional Paid-in Capital	Deferred Compensation	Deficit Accumulated During the Development Stage	Total Stockholders' Deficiency
		Shares	Amount					
Stock issued for cash on April 24, 2006	1.56	473,000	473	—	737,408	—	—	737,881
Stock issued upon exercise of warrants on April 26, 2006	0.50	125,000	125	—	62,375	—	—	62,500
Stock issued upon exercise of warrants on April 26, 2006	1.50	100,000	100	—	149,900	—	—	150,000
Common stock issued for convertible debt on April 26, 2006	0.70	35,714	36	—	24,964	—	—	25,000
Stock issued upon exercise of warrants on May 6, 2006	0.50	200,000	200	—	99,800	—	—	100,000
Stock issued upon exercise of warrants on May 15, 2006	1.50	25,000	25	—	37,475	—	—	37,500
Stock issued upon exercise of warrants on May 15, 2006	0.50	50,000	50	—	24,950	—	—	25,000
Stock issued for cash on June 7, 2006	1.89	873,018	872	—	1,649,136	—	—	1,650,008
Common stock issued for convertible debt on June 7, 2006	0.70	1,535,716	1,536	—	1,073,464	—	—	1,075,000
Stock issued upon exercise of warrants on June 8, 2006	0.50	900,000	900	—	449,100	—	—	450,000

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per <u>Share</u>	<u>Common Stock</u>		Common Stock to be <u>Issued</u>	Additional Paid-in <u>Capital</u>	Deferred <u>Compensation</u>	Deficit Accumulated During the Development <u>Stage</u>	Total Stockholders' <u>Deficiency</u>
		<u>Shares</u>	<u>Amount</u>					
Stock issued upon exercise of warrants on June 9, 2006	0.50	9,000	9	—	4,491	—	—	4,500
Stock issued upon exercise of warrants on June 23, 2006	0.50	150,000	150	—	74,850	—	—	75,000
Stock issued upon exercise of warrants on June 23, 2006	1.50	15,000	15	—	22,485	—	—	22,500
Common stock issued for convertible debt on June 30, 2006	0.70	219,104	219	—	153,155	—	—	153,374
Common stock issued for convertible debt on July 11, 2006	0.70	14,603	15	—	10,207	—	—	10,222
Common stock issued for convertible debt on August 7, 2006	0.70	1,540,160	1,540	—	1,076,572	—	—	1,078,112
Common stock issued upon exercise of warrants on August 7, 2006	1.50	175,000	175	—	262,325	—	—	262,500

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
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CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	<u>Price per</u>	<u>Common Stock</u>		<u>Common</u>	<u>Additional</u>	<u>Deferred</u>	<u>Deficit</u>	<u>Total</u>
	<u>Share</u>	<u>Shares</u>	<u>Amount</u>	<u>Stock</u>	<u>Paid-in</u>	<u>Compensation</u>	<u>Accumulated</u>	<u>Stockholders'</u>
				<u>to be</u>	<u>Capital</u>		<u>During the</u>	<u>Deficiency</u>
				<u>Issued</u>			<u>Development</u>	
							<u>Stage</u>	
Common stock issued upon exercise of warrants on August 21, 2006	1.50	50,000	50	—	74,950	—	—	75,000
Common stock issued for cash on August 22, 2006	1.00	14,519	15	—	14,504	—	—	14,519
Common stock issued upon exercise of warrants on August 23, 2006	1.00	3,683	4	—	3,679	—	—	3,683
Common stock issued upon exercise of warrants on August 28, 2006	1.50	5,000	5	—	7,495	—	—	7,500
Common stock issued for convertible debt on September 13, 2006	0.70	4,286	4	—	2,996	—	—	3,000
Common stock issued upon exercise of warrants on September 13, 2006	0.50	150,000	150	—	74,850	—	—	75,000

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
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CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per <u>Share</u>	<u>Common Stock</u>		Common Stock to be <u>Issued</u>	Additional Paid-in <u>Capital</u>	Deferred <u>Compensation</u>	Deficit Accumulated During the Development <u>Stage</u>	Total Stockholders' <u>Deficiency</u>
		<u>Shares</u>	<u>Amount</u>					
Common stock issued for convertible debt on October 16, 2006	0.70	66,654	67	—	46,591	—	—	46,658
Common stock issued upon exercise of warrants on November 3, 2006	0.50	210,000	210	—	104,790	—	—	105,000
Common stock issued for put on equity line of credit on November 7, 2006	1.22	94,4700	94	—	115,368	—	—	115,462
Common stock issued for put on equity line of credit on November 14, 2006	1.14	7,300	7	—	8,349	—	—	8,356
Common stock issued for put on equity line of credit on November 27, 2006	0.83	27,500	28	—	22,913	—	—	22,941
Common stock issued for put on equity line of credit on November 28, 2006	0.82	36,500	36	—	30,059	—	—	30,095
Common stock issued for put on equity line of credit on December 6, 2006	0.78	73,863	74	—	57,244	—	—	57,318

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
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CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	<u>Price per Share</u>	<u>Common Stock</u>		<u>Common Stock to be Issued</u>	<u>Additional Paid-in Capital</u>	<u>Deferred Compensation</u>	<u>Deficit Accumulated During the Development Stage</u>	<u>Total Stockholders' Deficiency</u>
		<u>Shares</u>	<u>Amount</u>					
Common stock issued for put on equity line of credit on December 26, 2006	0.55	18,800	19	—	10,377	—	—	10,396
Common stock issued for put on equity line of credit on December 31, 2006	0.59	229,050	229	—	135,300	—	—	135,529
Common stock paid for, but not issued	—	—	—	60,000	—	—	—	60,000
Fair value of options issued to employees and officers	—	—	—	—	2,253,263	—	—	2,253,263
Fair value of warrants issued for services	—	—	—	—	401,130	—	—	401,130
Write off of deferred compensation	—	—	—	—	(142,187)	142,187	—	—
Warrants issued for consulting	—	—	—	—	62,497	—	—	62,497
Warrants issued with convertible notes	—	—	—	—	408,596	—	—	408,596

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
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CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per <u>Share</u>	<u>Common Stock</u>		Common Stock to be Issued	Additional Paid-in Capital	Deferred Compensation	Deficit Accumulated During the Development Stage	Total Stockholders' Deficiency
		<u>Shares</u>	<u>Amount</u>					
Intrinsic value of beneficial conversion associated with convertible notes	—	—	—	—	851,100	—	—	851,100
Finders fees related to stock issuances	—	—	—	—	(284,579)	—	—	(284,579)
Fees paid on equity line of credit	—	—	—	—	(30,402)	—	—	(30,402)
Net loss for year ended December 31, 2006	—	—	—	—	—	—	(10,181,523)	(10,181,523)
Balance, December 31, 2006		40,081,757	\$ 40,082	\$ 60,000	\$29,430,821	\$ —	\$ (30,427,597)	\$ (896,694)
Common stock issued for put on equity line of credit on January 11, 2007	0.63	63,000	63	—	39,659	—	—	39,722
Common stock issued for put on equity line of credit on January 22, 2007	0.73	58,150	58	—	42,246	—	—	42,304
Common stock issued for put on equity line of credit on February 9, 2007	0.73	35,800	36	—	26,009	—	—	26,045

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
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CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	<u>Price per</u>	<u>Common Stock</u>		<u>Common</u>	<u>Additional</u>	<u>Deferred</u>	<u>Deficit</u>	<u>Total</u>
	<u>Share</u>	<u>Shares</u>	<u>Amount</u>	<u>Stock</u>	<u>Paid-in</u>	<u>Compensation</u>	<u>Accumulated</u>	<u>Stockholders'</u>
				<u>to be</u>	<u>Capital</u>		<u>During the</u>	<u>Deficiency</u>
				<u>Issued</u>			<u>Stage</u>	
Common stock issued for put on equity line of credit on February 16, 2007	0.70	162,000	162	—	112,979	—	—	113,141
Common stock issued for put on equity line of credit on February 26, 2007	0.66	71,000	71	—	46,761	—	—	46,832
Common stock issued for put on equity line of credit on March 5, 2007	0.66	42,600	43	—	28,056	—	—	28,099
Common stock issued for put on equity line of credit on March 12, 2007	0.67	92,900	93	—	62,085	—	—	62,178
Common stock issued for put on equity line of credit on March 19, 2007	0.64	47,500	48	—	30,362	—	—	30,410
Common stock issued for put on equity line of credit on March 26, 2007	0.63	7,500	7	—	4,722	—	—	4,729
Common stock issued for put on equity line of credit on March 31, 2007	0.61	25,500	25	—	15,558	—	—	15,583
Fees paid on equity line of credit	—	—	—	—	(32,723)	—	—	(32,723)
Warrants issued with convertible notes	—	—	—	—	291,936	—	—	291,936

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
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CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per <u>Share</u>	<u>Common Stock</u>		Common Stock to be <u>Issued</u>	Additional Paid-in <u>Capital</u>	Deferred <u>Compensation</u>	Deficit Accumulated During the Development <u>Stage</u>	Total Stockholders' <u>Deficiency</u>
		<u>Shares</u>	<u>Amount</u>					
Common stock issued for put on equity line of credit on April 9, 2007	0.63	56,300	56	—	35,441	—	—	35,497
Common stock issued for put on equity line of credit on April 17, 2007	0.56	73,835	74	—	41,466	—	—	41,540
Common stock issued for put on equity line of credit on April 24, 2007	0.56	122,857	123	—	68,996	—	—	69,119
Common stock issued for put on equity line of credit on May 1, 2007	0.55	226,081	226	—	124,774	—	—	125,000
Common stock issued for put on equity line of credit on May 8, 2007	0.66	29,400	29	—	19,363	—	—	19,392

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
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CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per <u>Share</u>	<u>Common Stock</u>		Common Stock to be <u>Issued</u>	Additional Paid-in <u>Capital</u>	Deferred <u>Compensation</u>	Deficit Accumulated During the Development <u>Stage</u>	Total Stockholders' <u>Deficiency</u>
		<u>Shares</u>	<u>Amount</u>					
Common stock issued for put on equity line of credit on May 15, 2007	0.43	403,502	404	—	171,811	—	—	172,215
Common stock issued for put on equity line of credit on May 22, 2007	0.39	119,800	120	—	46,362	—	—	46,482
Common stock issued for put on equity line of credit on May 30, 2007	0.33	80,996	81	—	26,631	—	—	26,712
Common stock issued for put on equity line of credit on June 6, 2007	0.32	54,700	55	—	17,454	—	—	17,509
Common stock issued for put on equity line of credit on June 15, 2007	0.27	94,500	95	—	25,571	—	—	25,666
Common stock issued for put on equity line of credit on June 21, 2007	0.31	12,500	12	—	3,868	—	—	3,880
Fees paid on equity line of credit	—	—	—	—	(46,641)	—	—	(46,641)

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
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CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per <u>Share</u>	<u>Common Stock</u>		Common Stock to be <u>Issued</u>	Additional Paid-in <u>Capital</u>	Deferred <u>Compensation</u>	Deficit Accumulated	
		<u>Shares</u>	<u>Amount</u>				<u>During the Development Stage</u>	<u>Total Stockholders' Deficiency</u>
Warrants issued with convertible notes	—	—	—	—	260,718	—	—	260,718
Fair value of options issued to an officer	—	—	—	—	8,898	—	—	8,898
Common stock issued, previously paid for	—	2,597,524	2,597	(60,000)	57,403	—	—	—
Fair value of options issued to officers	—	—	—	—	20,574	—	—	20,574
Warrants issued with convertible notes	—	—	—	—	267,930	—	—	267,930
Common stock issued for convertible debt on October 5, 2007	0.53	51,887	52	—	27,448	—	—	27,500
Common stock issued for convertible debt on November 12, 2007	0.37	255,081	255	—	94,125	—	—	94,380

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
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CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	<u>Price per</u>	<u>Common Stock</u>		<u>Common</u>	<u>Additional</u>	<u>Deferred</u>	<u>Deficit</u>	<u>Total</u>
	<u>Share</u>	<u>Shares</u>	<u>Amount</u>	<u>Stock</u>	<u>Paid-in</u>	<u>Compensation</u>	<u>Accumulated</u>	<u>Stockholders'</u>
				<u>to be</u>	<u>Capital</u>		<u>During the</u>	<u>Deficiency</u>
				<u>Issued</u>			<u>Development</u>	
							<u>Stage</u>	
Common stock issued for convertible debt on November 12, 2007	0.53	51,887	52	—	27,448	—	—	27,500
Common stock issued for convertible debt on November 14, 2007	0.34	80,882	81	—	27,419	—	—	27,500
Common stock issued for convertible debt on November 14, 2007	0.37	95,227	95	—	35,105	—	—	35,200
Common stock issued for convertible debt on November 15, 2007	0.37	163,514	164	—	60,336	—	—	60,500
Common stock issued for convertible debt on November 16, 2007	0.37	71,351	71	—	26,329	—	—	26,400
Common stock issued for convertible debt on November 16, 2007	0.34	80,882	81	—	27,419	—	—	27,500
Warrants issued with convertible notes	—	—	—	—	158,652	—	—	158,652

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
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CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price	Common Stock		Common	Additional	Deferred	Deficit	Total
	per			Stock	Paid-in	Compensation	Accumulated	Stockholders'
	Share	Shares	Amount	to be	Capital		During the	Deficiency
				Issued			Development	
							Stage	
Common stock to be issued for consulting services	—	—	—	4,000	—	—	—	4,000
Common stock issued for convertible debt on December 28, 2007	0.17	1,060,000	1,060	—	198,940	—	—	200,000
Fair value of options issued to an officer	—	—	—	—	21,818	—	—	21,818
Net loss for year ended December 31, 2007	—	—	—	—	—	—	(6,262,743)	(6,262,743)
Balance, December 31, 2007		46,470,413	\$ 46,471	\$ 4,000	\$32,280,083	\$ —	\$ (36,690,340)	\$ (4,359,786)
Fair value of warrants issued with convertible notes	—	—	—	—	116,913	—	—	116,913
Common stock issued for convertible debt on January 31, 2008	0.37	118,918	119	—	43,881	—	—	44,000
Common stock issued for convertible debt on January 31, 2008	0.39	279,232	279	—	108,621	—	—	108,900
Common stock issued for convertible debt on March 10, 2008	0.39	442,820	443	—	172,257	—	—	172,700

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
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CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per <u>Share</u>	<u>Common Stock</u>		Common Stock to be <u>Issued</u>	Additional Paid-in <u>Capital</u>	Deferred <u>Compensation</u>	Deficit Accumulated During the Development <u>Stage</u>	Total Stockholders' <u>Deficiency</u>	
		<u>Shares</u>	<u>Amount</u>						
Common stock issued for convertible debt on march 10, 2008		0.38	5,450,848	5,451	—	2,039,243	—	—	2,044,694
Common stock issued on March 10, 2008 for settlement of loan on January 31, 2008		0.37	80,000	80	—	29,603	—	—	29,683
Common stock issued on March 10, 2008 for settlement of payable on January 31, 2008		0.38	1,891,048	1,891	—	707,443	—	—	709,334
Common stock issued on March 10, 2008 for settlement of consulting services on December 13, 2007		0.40	10,000	10	(4,000)	3,990	—	—	—
Common stock issued on March 10, 2008 for settlement of payable on February 1, 2008		0.37	7,838	8	—	2,892	—	—	2,900
Common stock to be issued for settlement of payable		—	—	—	25,375	—	—	—	25,375
Common stock to be issued upon exercise of warrants on March 18, 2008		—	—	—	3,000	—	—	—	3,000

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	Price per <u>Share</u>	<u>Common Stock</u>		Common Stock to be Issued	Additional Paid- in <u>Capital</u>	Deferred <u>Compensation</u>	Deficit Accumulated During the Development <u>Stage</u>	Total Stockholders' <u>Deficiency</u>	
		<u>Shares</u>	<u>Amount</u>						
Common stock to be issued upon exercise of warrants on March 19, 2008		—	—	—	50,000	—	—	—	50,000
Common stock to be issued upon exercise of warrants on March 20, 2008		—	—	—	50,000	—	—	—	50,000
Common stock to be issued upon exercise of warrants on March 21, 2008		—	—	—	50,000	—	—	—	50,000
Common stock to be issued upon exercise of warrants on March 26, 2008		—	—	—	15,130	—	—	—	15,130
Common stock to be issued upon exercise of warrants on March 27, 2008		—	—	—	2,700	—	—	—	2,700
Common stock to be issued for notes converted on March 10, 2008		—	—	—	11,000	—	—	—	11,000
Common stock to be issued for notes converted on March 17, 2008		—	—	—	82,500	—	—	—	82,500
Common stock to be issued for notes converted on March 20, 2008		—	—	—	158,400	—	—	—	158,400

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	<u>Price per Share</u>	<u>Common Stock</u>		<u>Common Stock to be Issued</u>	<u>Additional Paid-in Capital</u>	<u>Deferred Compensation</u>	<u>Deficit Accumulated During the Development Stage</u>	<u>Total Stockholders' Deficiency</u>
		<u>Shares</u>	<u>Amount</u>					
Common stock to be issued for notes converted on March 21, 2008	—	—	—	11,000	—	—	—	11,000
Fair value of options issued to an officer	—	—	—	—	21,818	—	—	21,818
Fair value of warrants issued with convertible notes	—	—	—	—	96,883	—	—	96,883
Intrinsic value of beneficial conversion associated with convertible notes	—	—	—	—	117,739	—	—	117,739
Common stock issued for previously exercised warrants	0.50	341,660	342	(170,830)	170,488	—	—	—
Common stock issued for previous settlement of payable	0.30	84,583	85	(25,375)	25,290	—	—	—
Common stock issued for previously converted notes	0.39	28,206	28	(11,000)	10,972	—	—	—
Common stock issued for previously converted notes	0.50	503,800	504	(251,900)	251,396	—	—	—
Common stock issued upon exercise of warrants on April 1, 2008	0.50	100,000	100	—	49,900	—	—	50,000
Common stock issued upon exercise of warrants on April 4, 2008	0.50	100,000	100	—	49,900	—	—	50,000
Common stock issued upon exercise of warrants on April 4, 2008	0.50	22,990	23	—	11,472	—	—	11,495
Common stock issued upon exercise of warrants on April 14, 2008	0.50	100,000	100	—	49,900	—	—	50,000

(Continued)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (Continued)
FROM INCEPTION (FEBRUARY 18, 1998) TO JUNE 30, 2008

	<u>Price per Share</u>	<u>Common Stock</u>		<u>Common Stock to be Issued</u>	<u>Additional Paid-in Capital</u>	<u>Deferred Compensation</u>	<u>Deficit Accumulated During the Development Stage</u>	<u>Total Stockholders' Deficiency</u>
		<u>Shares</u>	<u>Amount</u>					
Common stock issued upon exercise of warrants on June 24, 2008	0.50	80,000	80	—	39,920	—	—	40,000
Common stock issued for convertible debt on April 24, 2008	0.41	132,769	133	—	54,867	—	—	55,000
Common stock issued for convertible debt on April 24, 2008	0.50	44,000	44	—	21,956	—	—	22,000
Common stock issued for convertible debt on June 17, 2008	0.34	760,295	760	—	257,740	—	—	258,500
Common stock issued for convertible debt on June 17, 2008	0.39	112,820	113	—	43,887	—	—	44,000
Common stock issued for convertible debt on June 17, 2008	0.50	198,000	198	—	98,802	—	—	99,000
Common stock issued for settlement of payable on June 20, 2008	0.33	71,429	71	—	23,533	—	—	23,604
Common stock upon exercise of warrants on June 23, 2008	0.50	320,000	320	—	159,680	—	—	160,000
Fair value of warrants issued with convertible notes	—	—	—	—	11,910	—	—	11,910
Fair value of options issued to an officer	—	—	—	—	21,818	—	—	21,818
Net loss for the three months ended June 30, 2008, 2008	—	—	—	—	—	—	(2,975,874)	(2,975,874)
Balance, June 30, 2008		<u>57,751,669</u>	<u>\$ 57,753</u>	<u>\$ —</u>	<u>\$37,094,797</u>	<u>\$ —</u>	<u>\$ (39,666,214)</u>	<u>\$ (2,513,664)</u>

See notes to condensed financial statements.

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
SIX MONTHS ENDED JUNE 30, 2008 AND 2007 AND FOR THE PERIOD
FEBRUARY 18, 1998 (DATE OF INCEPTION) TO JUNE 30, 2008

	June 30, 2008	June 30, 2007	Cumulative since inception
Cash flows from operating activities			
Net loss	\$ (2,975,874)	\$ (3,442,344)	\$ (39,666,214)
Adjustments to reconcile net loss to net cash used in operating activities:			
Write off of intangible assets	—	—	505,000
Settlement of litigation and debt	—	—	(1,017,208)
Fair value of stock compensation expense	43,636	25,200	2,965,708
Fair value of common stock issued for services	51,879	—	4,723,981
Fair value of warrants issued	116,913	—	116,913
Non-cash legal expense	236,572	—	236,572
Non-cash interest expense	691,381	—	691,331
Non-cash increase in convertible notes recorded as interest expense	89,470	—	163,962
Issuance of options for legal settlement	—	—	31,500
Issuance of warrants for legal settlement	—	—	4,957
Issuance of warrants for financing fees	—	47,104	82,444
Patent acquisition cost	—	—	1,610,066
Amortization of issuance costs and original issue debt	514,942	612,388	4,887,843
Amortization of deferred compensation	—	—	3,060,744
Loss on sale of equipment	9,683	—	9,683
Depreciation	19,447	110,035	375,046
Bad debt	1,380	—	1,380
Changes in operating assets and liabilities:			
Accounts receivable	—	—	(1,380)
Inventory	—	(19,879)	(30,256)
Prepaid expenses and other	(15,870)	7,950	(36,422)
Other assets	(6,750)	—	(11,250)
Accounts payable and accrued expenses	167,869	457,068	3,591,644
Net cash used in operating activities	<u>(1,055,372)</u>	<u>(2,202,478)</u>	<u>(17,761,809)</u>
Cash flows from investing activities			
Purchase of property and equipment	(345)	(45,713)	(553,452)
Proceeds from sale of equipment	17,477	—	17,477
Net cash provided by (used in) investing activities	<u>17,132</u>	<u>(45,713)</u>	<u>(535,975)</u>
Cash flows from financing activities			
Net proceeds under equity line of credit	—	912,691	1,262,386
Increase (decrease) in payables to related parties and shareholder	2,442	31,404	597,488
Advances from founding executive officer	—	—	517,208
Net proceeds from issuance of convertible notes and warrants	534,000	1,310,000	5,359,678
Repayment of convertible notes	—	(26,250)	(226,250)
Net proceeds from issuance of common stock and common stock issuable	532,325	—	10,787,274
Net cash provided by financing activities	<u>1,068,767</u>	<u>2,227,845</u>	<u>18,297,784</u>
Net increase (decrease) in cash	30,527	(20,346)	78,187
Cash, beginning of period	<u>47,660</u>	<u>244,228</u>	<u>—</u>
Cash, end of period	<u>\$ 78,187</u>	<u>\$ 223,882</u>	<u>\$ 78,187</u>

See notes to condensed consolidated financial statements.

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
SIX MONTHS ENDED JUNE 30, 2008 AND 2007 AND FOR THE PERIOD
FEBRUARY 18, 1998 (DATE OF INCEPTION) TO JUNE 30, 2008

	<u>June 30,</u> <u>2008</u>	<u>June 30,</u> <u>2007</u>	<u>Cumulative</u> <u>since</u> <u>inception</u>
Supplemental disclosures of cash flow information			
Cash paid during the period for			
Interest	\$ 621	\$ 7,674	\$ 135,665
Income taxes	\$ —	\$ 800	\$ 4,282
Non-cash investing and financing activities			
Acquisition of intangible asset through advance from related party and issuance of common stock	\$ —	\$ —	\$ 505,000
Deferred compensation for stock options issued for services	—	—	3,202,931
Purchase of property and equipment financed by advance from related party	—	—	3,550
Conversion of related party debt to equity	—	—	515,000
Issuance of common stock in settlement of payable	—	—	113,981
Cancellation of stock	—	—	8,047
Conversion of accounts payable and accrued expenses to common stock issued	—	—	612,521
Conversion of related party debt to convertible debentures	—	—	45,000
Issuance of shares for settlement of loans and other payable to Morale/Matthews	2,783,711	—	5,757,125
Write off of deferred compensation	—	—	142,187
Non-cash equity-warrant valuation and intrinsic value of beneficial conversion associated with convertible notes	226,532	566,248	4,192,957

See notes to condensed consolidated financial statements.

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
(A DEVELOPMENT STAGE ENTERPRISE)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SIX MONTHS ENDED JUNE 30, 2008 (UNAUDITED)

1. Organization and basis of presentation

Basis of presentation

The accompanying unaudited condensed consolidated financial statements of Save the World Air, Inc. (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Regulation S-K for scaled disclosures for smaller reporting companies. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in United States of America for complete financial statements. However, such information reflects all adjustments (consisting solely of normal recurring adjustments), which are, in the opinion of management, necessary for the fair presentation of the consolidated financial position and the consolidated results of operations. Results shown for interim periods are not necessarily indicative of the results to be obtained for a full fiscal year.

The condensed consolidated balance sheet information as of December 31, 2007 was derived from the audited consolidated financial statements included in the Company's Annual Report on Form 10-KSB filed with the SEC. These interim financial statements should be read in conjunction with that report.

Going Concern

The accompanying condensed consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. As reflected in the accompanying condensed consolidated financial statements, the Company had a net loss of \$2,975,874 and a negative cash flow from operations of \$1,055,372 for the six months ended June 30, 2008, and had a working capital deficiency of \$2,679,710 and a stockholders' deficiency of \$2,513,664 at June 30, 2008. These factors raise substantial doubt about the Company's ability to continue as a going concern. The ability of the Company to continue as a going concern is dependent upon the Company's ability to raise additional funds and implement its business plan. The condensed consolidated financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

Description of business

Save the World Air, Inc. (the "Company") is a green technology company that leverages a suite of patented, patent-pending and licensed intellectual properties related to the treatment of fuels. These technologies utilize either magnetic or uniform electrical fields to alter physical characteristics of fuels and are designed to create a cleaner combustion. Cleaner combustion has been shown to improve performance, enhance fuel economy and/or reduce harmful emissions in laboratory testing.

The Company was incorporated in Nevada on February 18, 1998 under the name Mandalay Capital Corp. The Company changed its name to Save the World Air, Inc. on February 11, 1999 following the purchase of the worldwide exclusive manufacturing, marketing and distribution rights for the ZEFS technology.

During the past several years, the Company has been acquiring new technologies, developing prototype products using the Company's technologies and conducting scientific tests regarding the technologies and prototype products. The Company's ECO ChargR™ and MAG ChargR™ products, use fixed magnetic fields to alter some physical properties of fuel, by incorporating our patented and patent-pending ZEFS, MK IV technologies. When fitted to an internal combustion engine, these products are expected to increase power and improve mileage and may also reduce carbon monoxide, hydrocarbons and nitrous oxide emissions and to. The Company also has developed certain products incorporating its CAT-MATE technology, although at this time the Company does not intend to devote significant effort to the commercialization of products incorporating the CAT-MATE technology.

The Company has entered into two License Agreements with Temple University, one covering Temple University's current patent application concerning certain electric field effects on gasoline, kerosene and diesel fuel particle size distribution, and the other covering Temple University's current patent application concerning electric field effects on crude oil and edible oil viscosity, and any and all United States and foreign patents issuing in respect of the technologies described in such applications. Initially, the License Agreements are exclusive and the territory licensed to the Company is worldwide. Pursuant to the License Agreements, the Company will pay to Temple University (i) license fees in the aggregate amount of \$250,000, payable in three installments of \$100,000, the first installment of which was paid in March 2007, and \$75,000 on each of February 2, 2008, which has not been paid, and February 2, 2009, respectively; and (ii) annual maintenance fees of \$125,000 annually commencing January 1, 2008, which has not been paid. In addition, each License Agreement separately provides that the Company will pay royalties to Temple University on net sales of products incorporating the technology licensed under that License Agreement in an amount equal to 7% of the first \$20 million of net sales, 6% of the next \$20 million of net sales and 5% of net sales in excess of \$40 million. Sales under the two License Agreements are not aggregated for purposes of calculating the royalties payable to Temple University. In addition, the Company has agreed to bear all costs of obtaining and maintaining patents in any jurisdiction where the Company directs Temple University to pursue a patent for either of the licensed technologies. Should the Company not wish to pursue a patent in a particular jurisdiction, that jurisdiction would not be included in the territory licensed to the Company. At June 30, 2008, the Company owed Temple University \$428,000, which is included in accounts payable-other. During the three and six month periods ended June 30, 2008, the Company recorded \$59,750 and \$313,500, respectively, of fees due to Temple University and are included research and development expenses.

The Company is in default in connection with its payment obligations under the License Agreements. Nonetheless, the Company has not received any written notice from Temple University of a material breach relating to required payments under the License Agreements. Any such notice must provide the Company with 60 days' notice to cure the material breach. Should the Company receive such notice, the Company's failure to cure could result in a termination of the License Agreements. Under the License Agreements the Company must pay a penalty equal to 1% per month of the amounts due and unpaid under the License Agreements.

The Company has also entered into a research and development agreement (R&D Agreement) with Temple University to conduct further research on the ELEKTRA technology. Under the R&D Agreement Temple University will conduct a 24-month research project towards expanding the scope of, and developing products utilizing, the technologies covered under the License Agreements, including design and manufacture of prototypes utilizing electric fields to improve diesel, gasoline and kerosene fuel injection in engines using such fuels and a device utilizing a magnetic field to reduce crude oil viscosity for crude oil (paraffin and mixed base) and edible oil flow in pipelines. Pursuant to the R&D Agreement, the Company will make payments to Temple University in the aggregate amount of \$500,000, payable in eight non-refundable installments commencing with \$123,750, which was paid in March 2007, and seven payments of \$53,750 every three months thereafter until paid in full. The payments of \$53,750 due in June, September, December 2007, March 2008 and June 2008 have not been paid. The Company is in default under the R&D Agreement, however, the Company has not received any notice of default from Temple University. If the research project yields results within the scope of the technologies licensed pursuant to the License Agreements, those results will be deemed included as rights licensed to the Company pursuant to the License Agreements. If the research project yields results outside of the scope of the technologies covered by the License Agreements, the Company has a six-month right of first negotiation to enter into a new worldwide, exclusive license agreement with Temple University for the intellectual property covered by those results.

The Company's focus is on product development and marketing of proprietary devices that are designed to reduce harmful emissions, and improve fuel efficiency and engine performance on equipment and vehicles driven by internal combustion engines and has not yet generated meaningful revenues. The technologies are called "ZEFS", "MK IV", "ELEKTRA" and "CAT-MATE". The Company is currently marketing its ECO and MAG ChargeR products incorporating ZEFS and MK IV technologies in the United States and certain countries in Asia; and the Company is in the early stages of developing ELEKTRA products. Expenses have been funded primarily through the sale of company stock, convertible notes and the exercise of warrants.

The Company has taken actions to secure the intellectual property rights to the ZEFS, MK IV and CAT-MATE devices and is the worldwide exclusive licensee for patent pending technologies associated with the development of ELEKTRA.

The accompanying condensed consolidated financial statements of Save the World Air, Inc. and Subsidiary include the accounts of Save the World Air, Inc. and its wholly-owned subsidiary STWA Asia Pte. Limited. Inter-company transactions and balances have been eliminated in consolidation

2. Significant Accounting Policies

Revenue Recognition

The Company has adopted Staff Accounting Bulletin 104, "Revenue Recognition" and therefore recognizes revenue based upon meeting four criteria:

- Persuasive evidence of an arrangement exists;
- Delivery has occurred or services rendered;
- The seller's price to the buyer is fixed or determinable; and
- Collectability is reasonably assured.

The Company contract manufactures fixed magnetic field products and sells them to various original equipment manufacturers in the

motor vehicle and small utility motor markets. The Company negotiates an initial contract with the customer fixing the terms of the sale and then receives a letter of credit or full payment in advance of shipment. Upon shipment, the Company recognizes the revenue associated with the sale of the products to the customer.

Development stage enterprise

The Company is a development stage enterprise as defined by Statement of Financial Accounting Standards (SFAS) No. 7, "Accounting and Reporting by Development Stage Enterprises." All losses accumulated since the inception of the Company have been considered as part of the Company's development stage activities.

Inventories

Inventories are valued at the lower of cost (first-in, first-out) or market and consist of finished goods.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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 date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Certain significant estimates were made in connection with preparing the Company's financial statements. Actual results could differ from those estimates.

Stock-based compensation

The Company periodically issues stock options and warrants to employees and non-employees in capital raising transactions, for services and for financing costs. The Company adopted SFAS No. 123R effective January 1, 2006, and is using the modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123R for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123R for all awards granted to employees prior to the effective date of SFAS No. 123R that remain unvested on the effective date. The Company accounts for stock option and warrant grants issued and vesting to non-employees in accordance with EITF No. 96-18: "Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services" and EITF No. 00-18 "Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees" whereas the value of the stock compensation is based upon the measurement date as determined at either a) the date at which a performance commitment is reached, or b) at the date at which the necessary performance to earn the equity instruments is complete.

Stock-based compensation expense recognized under SFAS 123(R) for employee and directors for the six months ended June 30, 2008 and 2007 was \$43,636 and \$25,200 respectively.

Financial Assets and Liabilities Measured at Fair Value

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements. This Statement defines fair value for certain financial and nonfinancial assets and liabilities that are recorded at fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This guidance applies to other accounting pronouncements that require or permit fair value measurements. On February 12, 2008, the FASB finalized FASB Staff Position (FSP) No. 157-2, Effective Date of FASB Statement No. 157. This Staff Position delays the effective date of SFAS No. 157 for nonfinancial assets and liabilities to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years, except for those items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The adoption of SFAS No. 157 had no effect on the Company's consolidated financial position or results of operations.

SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value into three broad levels, considering the relative reliability of the inputs. The fair value hierarchy assigns the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of an input to the valuation that is significant to the fair value measurement.

Loss per share

Basic earnings (loss) per share is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the potential dilution, using the treasury stock method, that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. In computing diluted earnings per share, the treasury stock method assumes that outstanding options and warrants are exercised and the proceeds are used to purchase common stock at the average market price during the period. Options and warrants may have a dilutive effect under the treasury stock method only when the average market price of the common stock during the period exceeds the exercise price of the options and warrants. For the six months ended June 30, 2008 and 2007, the dilutive impact of outstanding stock options of 1,901,225 and 4,039,559 respectively, and outstanding warrants of 13,319,020 and 21,631,197 have been excluded because their impact on the loss per share is anti-dilutive.

Recent Accounting Pronouncements

In December 2007, the FASB issued FASB Statement No. 141 (R), "Business Combinations" (FAS 141(R)), which establishes accounting principles and disclosure requirements for all transactions in which a company obtains control over another business. Statement 141 (R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is prohibited.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51". SFAS No. 160 establishes accounting and reporting standards that require that the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated statement of financial position within equity, but separate from the parent's equity; the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income; and changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently. SFAS No. 160 also requires that any retained noncontrolling equity investment in the former subsidiary be initially measured at fair value when a subsidiary is deconsolidated. SFAS No. 160 also sets forth the disclosure requirements to identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, but will affect only those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. SFAS No. 160 must be applied prospectively as of the beginning of the fiscal year in which it is initially applied, except for the presentation and disclosure requirements. The presentation and disclosure requirements are applied retrospectively for all periods presented.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133," (SFAS No.161). SFAS No.161 requires enhanced disclosures about an entity's derivative and hedging activities, including (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedged items are accounted for under SFAS No. 133, and (iii) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This standard becomes effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Earlier adoption of SFAS 161 and, separately, comparative disclosures for earlier periods at initial adoption are encouraged. As SFAS No.161 only requires enhanced disclosures, this standard will have no impact on the Financial Statements

The Company does not believe that the adoption of the above recent pronouncements will have a material effect on the Company's consolidated results of operations, financial position, or cash flows.

Reclassifications

Certain reclassifications of the prior period amounts and presentation have been made to conform to the presentation adopted for the current period. The following reclassifications and presentation changes were made to the December 31, 2007 consolidated balance sheet to conform to the current period presentation: (a) the amounts previously presented for the Morale 2006 Note of \$671,992 presented as Convertible Debenture, Net-Other - Default, (b) the Morale 2007 Note of \$583,364 included with Convertible Debentures, Net-Other, (c) the Morale Loan of \$20,334 presented as Loan Payable-Other, and (d) the fees due to Matthews of \$472,762 included in Accounts Payable-Other were reclassified to the separate line item Loans and Other Payable Due to Morale/Matthews. These reclassifications have no effect on total assets, total shareholder's deficiency, net loss or cash flows as previously presented.

4. Certain relationships and related transactions

Loans from related parties

In May of 2007, a former officer and director of the Company loaned \$31,404 to pay a Company obligation and in August 2007, the same party loaned \$50,000 to the Company so that it could pay certain operating expenses. These amounts are unsecured, bear interest at 6% per annum and are due on demand. At June 30, 2008 and December 31, 2007, the balance of these loans including interest was \$86,038 and \$83,596, respectively.

Lease agreement with related party

During 2003, the Company entered into a sublease agreement with Scottish Glen Golf Company, Inc. (SGGC) to lease office space in North Hollywood, California for its principal executive offices. Bruce McKinnon, the former Chief Executive Officer and former Director of the Company, is a beneficial owner of the lessor.

In August 2005, the Company amended this sublease agreement. The original lease term was from November 1, 2003 through October 16, 2005 and carried an option to renew for two additional years with a 10 percent increase in the rental rate. Monthly rent under this lease is \$3,740 per month under this lease. The Company exercised its option to renew the lease through October 15, 2007.

In January 2006, the Company further amended this sublease agreement, as a result of taking more space and obtaining expanded support services. The term of the sublease was amended to July 31, 2007 and carries an option to renew for two additional years with a 10 percent increase in the rental rate. Monthly rent is \$6,208 per month under this amended sublease agreement. Additionally, the Company began leasing two additional office spaces for \$964 per month beginning July 2006 on a month-to-month basis. The Company did not exercise its option to renew this sublease.

On July 12, 2007, SGGC presented to the Company a Three-Day Notice to Pay or Quit, demanding payment of unpaid rent, additional rent and penalties. On July 19, 2007, SGGC sued the Company in Los Angeles Superior Court, alleging unlawful detainer by the Company of its then-leased corporate offices at 5125 Lankershim Boulevard, North Hollywood, California, and failure to pay past due rent and penalties in the aggregate amount of \$104,413, of which \$103,069 was accrued by the Company at December 31, 2007. The Company vacated the premises on July 25, 2007.

On April 30, 2008 the Company and SGGC settled their pending litigation relating to the Company's prior offices. Effective April 30, 2008, the Company agreed to pay SGGC \$51,000 in full settlement of SGGC's claims, and recorded \$52,069 as forgiveness of debt.

Investments from related parties

In June 2007, the Company received \$100,000 proceeds for investment in the Spring Offering, from an investor who is more than a 5% beneficial owner of STWA. (See Note 8-Convertible notes and warrants).

In December 2007, the Company received \$200,000 proceeds for investment in the Fall Offering from a Director who is more than a 5% beneficial owner of STWA. (See Note 8-Convertible notes and warrants).

Accounts Payable to related parties

As of June 30, 2008, the Company had accounts payable to related parties in the amount of \$289,718, which was composed of \$237,413 in unpaid Directors Fees, \$35,305 in unreimbursed expenses incurred by Officers and Directors and \$17,000 accrual for past due rent and contested penalties payable to a company beneficially owned by a former Chief Executive Officer and Director. (See Note 12, Litigation Matters and Leases).

Marketing and promotional services agreement with related party

In July 2006, the Company entered into an agreement with SS Sales and Marketing Group ("SS Sales"), to provide exclusive marketing and promotional services in the western United States and western Canada (the "Territory") for the Company's products. SS Sales will also provide advice, assistance and information on marketing the Company's products in the automotive after-market, and will seek to recruit and establish a market with distributors, wholesalers and others. SS Sales will be paid a commission equal to 5% of the gross amount actually collected on contracts the Company entered into during the term of the agreement for existing or future customers introduced by SS Sales in the Territory. The agreement has a term of five years unless sooner terminated by either party on 30 days' notice. In the event of termination, SS Sales will be entitled to receive all commissions payable through the date of termination. No amount was due or paid under this agreement as of June 30, 2008. SS Sales is owned by Nathan Shelton, who has served as one of the directors of the Company since February 12, 2007.

5. Loans and other payable due to Morale/Matthews

Loans and other payable to Morale/Matthews consist of the following:

	<u>Maturity dates</u>	<u>June 30, 2008 (unaudited)</u>	<u>December 31, 2007</u>
Note payable Morale Orchards, LLC, 2006 Note	December 5, 2006	\$ -	\$ 671,992
Note payable Morale Orchards, LLC, 2007 Note	January 10, 2007	-	601,250
Discount on Morale Orchards, LLC 2007 Note		-	(17,886)
Loan payable to Morale Orchards, LLC	Due on demand	-	20,334
Fees due to Matthews & Partners	-	-	472,762
Total		\$ -	\$ 1,748,452

Leodis Matthews, through his law firm, Matthews & Partners, ("Matthews") serves as outside legal counsel to the Company. Morale Orchards LLC ("Morale") is beneficially owned by Jacqueline Alexander, the wife of Leodis Matthews. At December 31, 2007, the Company owed Morale/Matthews \$1,748,452 for debt and legal fees. This amount increased to \$1,855,808 at January 31, 2008.

Morale had previously purchased two convertible promissory notes. Each note was for \$612,500. One note was purchased December 5, 2006 (the "2006 Morale Note") and another was purchased January 10, 2007 (the "2007 Morale Note"). The notes were unsecured, due one year from the date issued, had an implied interest rate of 22.5%, and warrants were issued with the notes. The aggregate purchase price for the notes and warrants was \$1,000,000.

The 2006 Morale Note was convertible at the rate of \$0.85 per share into 720,588 shares of the Company's common stock, and the 2007 Morale Note was convertible at the rate of \$0.70 per share into 875,000 shares of the Company's common stock. The warrant issued with the 2006 Note was exercisable at \$0.85 per share, for 360,294 shares of the Company's common stock. The warrant issued with the 2007 Morale Note was exercisable at \$.70 per share, for 437,500 shares of the Company's common stock.

As of January 31, 2008, both the 2006 and 2007 Morale Notes were in default. The note agreements provided if the notes are not paid when due, the principal balance shall be increased by 10% and the Company shall pay interest at 2.5% per month (30% per annum) until the note is paid. At January 31, 2008, the total amount due for the 2006 Morale Note and the 2007 Morale Note was \$689,327 and \$672,885 respectively.

In addition to the 2006 and 2007 Morale Notes, the Company borrowed \$20,000 from Morale on October 30, 2007 (the "\$20,000 Note"), at an interest rate of ten percent (10%) per annum. Principal and accrued interest under the Morale Note is due on demand, and no payments there under have been made by the Company. At January 31, 2008, the Company was also indebted to Matthews \$472,762 for past legal fee.

Effective January 31, 2008, the Company, Morale, and Matthews agreed to a settlement of the Company's loans due Morale and fees due Matthews. Morale agreed to waive all accrued interest on the notes after January 31, 2008, and Morale and Matthews agreed to accept 7,421,896 shares of common stock of the Company as payment of the notes payable and fees.

On March 10, 2008, the Company issued 5,530,848 shares of the Company's common stock valued at \$2,101,722 to Morale for the conversion of the 2006 and 2007 Morale Notes (totaling \$1,362,212) and cancellation of \$20,000 Note. Also on March 10, 2008, the Company issued 1,891,048 shares of the Company's common stock valued at \$718,598 to Matthews in exchange for settlement of the legal fees due Matthews of \$472,762.

The fair value of the shares of common stock issued was determined to be \$0.38 per share, based on the closing price of the Company's common stock on January 31, 2008, for a total settlement of \$2,820,320. As a result of the issuance of shares of common stock, the Company incurred additional non-cash interest expense of \$719,510 and non-cash legal expense of \$245,836 which was recorded in the first quarter of 2008.

6. Convertible Debentures

Convertible debentures consist of the following:

	Maturity dates	June 30, 2008 (unaudited)	December 31, 2007
2007 Spring Offering	July 2, 2008	27,500	341,000
2007 Summer Offering	August 7, 2008 to September 24, 2008	49,500	93,500
2007 Fall Offering	November 13, 2008 to December 16, 2008	286,000	622,600
2007-2008 Winter Offering	February 21, 2009 to February 26, 2009	148,500	-
2008 Spring Offering	May 27, 2009	66,000	-
Less, remaining debt discount		<u>(117,796)</u>	<u>(334,920)</u>
Total		459,704	722,180
Convertible debentures, net, related parties		<u>(185,134)</u>	<u>(227,136)</u>
Convertible debentures, net, others		<u>\$ 274,570</u>	<u>\$ 495,044</u>

2007 Spring Offering

From June 13, 2007 through June 26, 2007, the Company conducted a private offering (the "Spring 2007 Offering") of up to \$550,000 aggregate face amount of its convertible notes (the "Spring 2007 Notes") with a small number of accredited investors. Of this amount, \$451,000 aggregate face amount of the Spring 2007 Notes were sold for an aggregate purchase price of \$410,000 net proceeds. Therefore, while the stated interest rate on the Spring 2007 Notes is 0%, the implied interest rate on the Spring 2007 Notes is 10%. The Spring 2007 Notes mature on the first anniversary of their date of issuance. The Spring 2007 Notes are convertible, at the option of the noteholders, into shares of common stock of the Company (the "Conversion Shares") at an initial conversion price equal to the average of the closing bid price of the Company's common stock for the five trading days preceding the closing dates of the Spring 2007 Offering (the "Conversion Prices"). On the first closing, 1,002,941 Conversion Shares are issuable at Conversion Price of \$0.34 per share. On the second closing, 207,548 conversion shares are issuable at a conversion price of \$0.53 per share. The per share price of the Company's common stock on the Pink Sheets during this period ranged from a low bid price (intraday) of \$0.35 to a high bid price (intraday) of \$0.59.

Each of the investors in the Spring 2007 Offering also received a warrant (the "Spring 2007 Warrants"), entitling the holder to purchase a number of shares of the Company's common stock equal to 50% of the number of shares of common stock into which the Spring 2007 Notes are convertible (the "Warrant Shares"). Each Spring 2007 Warrant is exercisable on a cash basis only at an initial price of \$0.50 per share, and is exercisable immediately upon issuance and for a period of two years from the date of issuance. A total of 605,242 Warrant Shares were issued. As of June 30, 2008, investors have converted \$423,500 of the Convertible Notes into 1,158,602 shares of the Company's common stock. The outstanding balance at June 30, 2008 is \$27,500.

The aggregate value of the Spring 2007 Offering Warrants issued in connection with the June 13, 2007 closing were valued at \$59,296 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 5.11%; dividend yield of 0%; volatility factors of the expected market price of common stock of 113.56%; and an expected life of two years (statutory term) and vest immediately upon issuance. The Company also determined that the notes contained a beneficial conversion feature of \$119,472. The value of the Spring 2007 Offering Warrants of \$59,296, the conversion option of \$119,472, and the transaction fees of \$31,000 are considered as debt discount and are being amortized over the life of the Note.

The aggregate value of the Spring 2007 Offering Warrants issued in connection with the June 26, 2007 closing were valued at \$19,580 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 5.11%; dividend yield of 0%; volatility factors of the expected market price of common stock of 117.65%; and an expected life of two years (statutory term) and vest immediately upon issuance. The Company also determined that the notes contained a beneficial conversion feature of \$21,655. The value of the Spring 2007 Offering Warrants of \$19,580, the conversion option of \$21,655 and the transaction fees of \$112,500 are considered as debt discount and are being amortized over the life of the Note.

2007 Summer Offering

From August 8, 2007 through September 27, 2007, the Company conducted a private offering (the "Summer 2007 Offering") of up to \$330,000 aggregate face amount of its convertible notes (the "Summer 2007 Notes") with a small number of accredited investors. Of this amount, \$309,980 aggregate face amount of the Summer 2007 Notes were sold for an aggregate purchase price of \$281,800 net proceeds. While the stated interest rate on the Summer 2007 Notes is 0%, the implied interest rate on the Summer 2007 Notes is 10%. The Summer 2007 Notes mature on the first anniversary of their date of issuance. The Summer 2007 Notes are convertible, at the option of the noteholder, into shares of common stock of the Company (the "Conversion Shares") at a conversion price equal to the average of the closing bid price of the Company's common stock for the five trading days preceding the closing date of the Summer 2007 Offering (the "Conversion Prices"). Up to 837,784 Conversion Shares are issuable at a Conversion Price of \$0.37 per share.

Each of the investors in the Summer 2007 Offering also received a warrant (the "Summer 2007 Warrants"), entitling the holder to purchase a number of shares of the Company's common stock equal to 50% of the number of shares of common stock into which the Summer 2007 Notes are convertible (the "Warrant Shares"). Each Summer 2007 Warrant is exercisable on a cash basis only at a price of \$0.50 per share, and is exercisable for a period of two years from the date of issuance. A total of 418,892 Warrant Shares were issued. As of June 30, 2008, investors have converted \$260,480 of the Convertible Notes into 704,091 shares of the Company's common stock. The outstanding balance at June 30, 2008 is \$49,500.

The aggregate value of the Summer 2007 Offering Warrants issued in connection with the September 28, 2007 closing were valued at \$60,678 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 4.87%; dividend yield of 0%; volatility factors of the expected market price of common stock of 124.83%; and an expected life of two years (statutory term) and vest immediately upon issuance. The Company also determined that the notes contained a beneficial conversion feature of \$69,055. The value of the Summer 2007 Offering Warrants of \$60,678, the conversion option of \$69,055 and the transaction fees of \$28,180 are considered as debt discount and are being amortized over the life of the Note.

2007 Fall Offering

From November 14, 2007 through December 17, 2007, the Company conducted a private offering (the "Fall 2007 Offering") of up to \$1,100,000 aggregate face amount of its convertible notes (the "Fall 2007 Notes") with a small number of accredited investors. Of this amount, \$622,600 aggregate face amount of the Fall 2007 Notes were sold for an aggregate purchase price of \$566,000 net proceeds. While the stated interest rate on the Fall 2007 Notes is 0%, the implied interest rate on the Fall 2007 Notes is 10%. The Fall 2007 Notes mature on the first anniversary of their date of issuance. The Fall 2007 Notes are convertible, at the option of the noteholder, into shares of common stock of the Company (the "Conversion Shares") at a conversion price equal to the average of the closing bid price of the Company's common stock for the five trading days preceding the closing date of the Fall 2007 Offering (the "Conversion Prices"). Up to 1,596,410 Conversion Shares are issuable

at a Conversion Price of \$0.39 per share.

Each of the investors in the Fall 2007 Offering also received a warrant (the "Fall 2007 Warrants"), entitling the holder to purchase a number of shares of the Company's common stock equal to 50% of the number of shares of common stock into which the (Fall 2007 Notes) are convertible (the "Warrant Shares"). Each Fall 2007 Warrant is exercisable on a cash basis only at a price of \$0.50 per share, and is exercisable for a period of two years from the date of issuance. Up to 796,205 Warrant Shares are initially issuable on exercise of the Fall 2007 Warrants. 000.

The aggregate value of the Fall 2007 Offering Warrants issued in connection with the December 17, 2007 closing were valued at \$95,290 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 5.11%; dividend yield of 0%; volatility factors of the expected market price of common stock of 137.25%; and an expected life of two years (statutory term) and vest immediately upon issuance. The Company also determined that the notes contained a beneficial conversion feature of \$63,362. The value of the Fall 2007 Offering Warrants of \$95,290, the conversion option of \$63,362, and the transaction fees of \$56,600 are considered as debt discount and are being amortized over the life of the Note.

As of June 30, 2008, 863,078 shares of the Company's common stock were issued to noteholders in the 2007 Fall Offering who converted and cancelled Convertible Notes in the amount of \$336,800. The outstanding balance at June 30, 2008 is \$286,000.

2007-2008 Winter Offering

From December 27, 2007 to February 29, 2008 the Company conducted an offering (the "2008 Winter Offering") of up to \$1,000,000 aggregate face amount of its convertible notes (the "2008 Winter Notes") with a small number of accredited investors. Of this amount, \$521,400 aggregate face amount of the 2008 Winter Notes were sold for an aggregate purchase price of \$474,000 net proceeds. Therefore, while the stated interest rate on the 2008 Winter Notes is 0%, the implied interest rate on the 2008 Winter Notes is 10%. The 2008 Winter Notes mature on the first anniversary of their date of issuance. The 2008 Winter Notes are convertible, at the option of the noteholder, into shares of common stock of the Company (the "Conversion Shares") at a conversion price equal to the average of the closing bid price of the Company's common stock for the five trading days preceding the closing date of the 2008 Winter Offering (the "Conversion Price"). Up to \$1,042,800 Conversion Shares are issuable at a Conversion Price of \$0.50 per share.

Each of the investors in the 2008 Winter Offering received, for no additional consideration, a warrant (the "2008 Winter Warrants"), entitling the holder to purchase a number of shares of the Company's common stock equal to 50% of the number of shares of common stock into which the (2008 Winter Notes) are convertible (the "2008 Warrant Shares") Each 2008 Winter Warrant is exercisable on a cash basis only at a Price of \$0.50 per share, and is exercisable for a period of two years from the date of issuance. Up to 521,400 2008 Warrant Shares are initially issuable on exercise of the 2008 Winter Warrants. As of June 30, 2008, investors have converted \$372,900 of the Convertible Notes into 745,800 shares of the Company's common stock. The outstanding balance at June 30, 2008 is \$148,500.

2008 Spring Offering

On May 27, 2008, the Company made an offering (the "2008 Spring Offering") with a certain investor of which, \$66,000 face amount of the 2008 Spring Note was sold for \$60,000 net proceeds. Therefore, while the stated interest rate on the 2008 Spring Note is 0%, the implied interest rate on the 2008 Spring Note is 10%. The 2008 Spring Note will mature on the first anniversary of the date of issuance. The 2008 Spring Note is convertible, at the option of the noteholder, into shares of common stock of the Company (the "Conversion Shares") at a conversion price equal to the average of the closing bid price of the Company's common stock for the five trading days preceding the closing date of the 2008 Spring Offering (the "Conversion Price"). The 132,000 Conversion Shares are issuable at a Conversion Price of \$0.50 per share.

The investor in the 2008 Spring Offering received, for no additional consideration, a warrant (the "2008 Spring Warrants"), entitling the holder to purchase a number of shares of the Company's common stock equal to 50% of the number of shares of common stock into which the (2008 Spring Notes) are convertible (the "2008 Spring Warrant Shares"). The 2008 Spring Warrant Shares is exercisable on a cash basis only at a Price of \$0.50 per share, and is exercisable for a period of two years from the date of issuance. The 66,000 2008 Spring Warrant Shares are initially issuable upon exercise of the 2008 Spring Warrants.

2007 PIPE Offering

During the year ended December 31, 2007, the Company conducted an offering (the "2007 PIPE Offering"), through Spencer Clarke LLC, as exclusive placement agent, of up to \$2,000,000 principal amount of its 10% convertible notes (the "2007 PIPE Notes"). Interest on the 2007 PIPE Notes, at a rate of 10% per annum, is payable quarterly. The Notes are due nine months from date of issuance. The 2007 PIPE Notes are convertible into shares of common stock at an initial conversion price of \$0.70 per share (the "Conversion Shares"). There is no reset to the conversion price for any beneficial conversion feature.

The Company has the right to redeem any or all of the outstanding 2007 PIPE Notes in its sole discretion anytime after the termination of the 2007 PIPE Offering and prior to the maturity date of the 2007 PIPE Notes. The redemption price shall be the face amount of the redeemed 2007 PIPE Notes plus accrued and unpaid interest thereon. Subject to the following sentence, at any time prior to the maturity date of the 2007 PIPE Notes, for each additional \$1,000,000 of gross proceeds raised from one or more offerings of the Company's equity or quasi-equity securities, the Company shall redeem 2007 PIPE Notes with a minimum face value of \$500,000 together with accrued and unpaid interest, until the entire outstanding 2007 PIPE Note is redeemed. Certain financings that the Company may conduct outside of North America are exempt from this provision to redeem the 2007 PIPE Notes in whole or in part.

Investors in the 2007 PIPE Offering also received a warrant (the "2007 PIPE Warrant"), entitling the holder to purchase a number of shares of the Company's common stock equal to 150% of the number of shares of common stock into which the 2007 PIPE Notes are convertible (the "Warrant Shares"). The 2007 PIPE Warrant will be exercisable on a cash basis only and will have registration rights. The 2007 PIPE Warrant is exercisable at an initial price of \$1.00 per share, and is exercisable immediately upon issuance and for a period of three years from the date of issuance.

Promptly, but no later than 90 days following the closing date of the 2007 PIPE Offering, the Company is required to file a Registration Statement with the SEC to register the Conversion Shares and the Warrant Shares. The Company shall use its best efforts to ensure that such Registration Statement is declared effective within 120 days after filing

Pursuant to the terms of the PIPE Notes, if a Registration Statement is not filed on the 91st day following the closing date, (i) the interest rate on the PIPE Notes increased from 10% to 18% per annum until the event of default is cured and (ii) the holders of the PIPE Notes became entitled to receive additional warrants in an amount equal to 25% of the PIPE Warrants originally issued, for each 60-day period that the Company remains in default.

During the year ended December 31, 2007, the Company issued \$400,000 of the PIPE Notes which could be converted into 571,429 shares of the Company's common stock and 2007 PIPE Warrants to purchase 857,144 shares of the Company's common stock. These warrants expire March 1, March 30 and April 2, 2010 and are exercisable at a price of \$1.00 per share. The Company had related transaction fees of \$48,000, resulting in net proceeds to the Company of \$352,000. In addition to the transaction fees, warrants to purchase 57,143 shares of the Company's common stock were issued to Spencer Clarke LLC, the Company's exclusive placement agent for the 2007 PIPE Offering. These warrants expire March 1, March 30 and April 2, 2012 and are exercisable at a price of \$0.70 per share.

The aggregate value of the 2007 PIPE Warrants issued in connection with this offering and the warrants issued to the placement agent were valued at \$256,533 using the Black-Scholes option valuation model with the following assumptions: risk-free interest rate of 4.40% to 5.16%; dividend yield of 0%; volatility factors of the expected market price of common stock of 100.28% to 114.98%; and an expected life of two years (statutory term). The Company also determined that the notes contained a beneficial conversion feature of \$62,857

The Company was unable to meet its obligations to file the Registration Statement required under the terms of the 2007 PIPE Offering in a timely manner. In early July 2007, the Company began discussions with Spencer Clarke, acting on behalf of the holders of the PIPE Notes and PIPE Warrants, for an extension of time to file the Registration Statement. Notwithstanding such discussions, Spencer Clarke issued a Notice of Default dated August 1, 2007 (the "Notice") to the Company for its failure to file the Registration Statement in a timely manner.

On August 29, 2007, the Company entered into a Modification Agreement with the 2007 PIPE note holders. The Modification Agreement was entered into as a result of negotiations between the Company and Spencer Clarke, LLC ("Spencer Clarke"), the Company's exclusive placement agent for the 2007 PIPE Offering, after the Company failed to file with the Securities and Exchange Commission (the "SEC") in a timely manner a Registration Statement to register the shares of the Company's common stock into which the PIPE Notes are convertible and for which the PIPE Warrants may be exercised.

Pursuant to the Modification Agreement, the parties have agreed as follows:

- § Promptly, but no later than November 30, 2007 (instead of on or before July 2, 2007), the Company shall file the Registration Statement with the SEC to register the Conversion Shares and the Warrant Shares.
- § Effective August 1, 2007, the interest rate on the PIPE Notes shall be increased from 10% per annum to 18% per annum until such time as the Registration Statement is declared effective by the SEC.
- § The price at which the PIPE Notes may be converted into Conversion Shares (the "Conversion Price") shall be reduced from \$0.70 to \$0.45 per share.
- § Each Investor shall receive, for no additional consideration, additional warrants ("Additional Warrants") in an amount equal to an additional 50% of the PIPE Warrants originally issued pursuant to the terms of the 2007 PIPE Offering. These Additional Warrants total 428,575 and shall have the same registration rights as are described in the Private Placement Memorandum dated January 12, 2007 (the "Offering Memorandum") used in connection with the 2007 PIPE Offering applicable to the PIPE Warrants; shall be exercisable immediately upon issuance; shall remain exercisable for a period of five years from the date of the Modification Agreement, on a cash basis only, at an initial exercise price of \$0.45 per share; and shall, in all other respects, have the same terms and conditions, and be in the same form, as the PIPE Warrants.
- § If the Company does not file the Registration Statement with the SEC by November 30, 2007, each Investor shall receive, for no additional consideration, warrants ("Delay Warrants") in an amount equal to an additional 50% of the PIPE Warrants originally issued pursuant to the terms of the Offering Memorandum. The Delay Warrants shall have the same registration rights as are described in the Offering Memorandum applicable to the PIPE Warrants; shall be exercisable immediately upon issuance; shall remain exercisable for a period of five years from the date of this Agreement, on a cash basis only, at an initial exercise price of \$0.45 per share; and shall, in all other respects, have the same terms and conditions, and be in the same form, as the PIPE Warrants.

The terms and conditions of the Offering Memorandum, the PIPE Notes and the PIPE Warrants, to the extent not expressly amended in the Modification Agreement, remain in full force and effect. The issuance of the Additional Warrants ("Delay Warrants"), if any, and the reduction of the Conversion Price of the PIPE Notes, has the potential to dilute the percentage ownership interest of the Company's existing shareholders.

The aggregate value of the 2007 PIPE Warrants issued in connection with this Modification Agreement were valued at \$138,107 using the Black-Scholes valuation model with the following assumptions: risk-free interest rate of 4.43%; dividend yield of 0%; volatility factors of the expected market price of common stock of 113.55%; and an expected life of two years (statutory term).

On November 30, 2007, the Company and the Investors entered into the Second Modification Agreement and pursuant to this agreement have agreed as follows:

- § The Investors have agreed to forgive all accrued interest on their PIPE Notes, from the date of issuance thereof through December 14, 2007.
- § On December 14, 2007, the Company agreed to pay all Investors 50% of the principal amount of their original PIPE Notes which equals a total cash repayment of \$200,000. Additionally, in repayment of the other 50% of the principal amount of the original PIPE Notes, the Company, on December 14, 2007, agreed to issue to Investors a total of 1,060,000 shares of the Company's common stock (the "Conversion Shares").
- § Concurrently with the cash payment and the issuance of the Conversion Shares as noted in paragraph 2 above, the Investors agreed to deliver to the Company the original of the PIPE Notes, which will be marked and deemed cancelled and of no further force or effect.
- § In further consideration of the above terms and conditions, the Investors have agreed that the Company shall not be required to, and shall not, file a Registration Statement with the Securities and Exchange Commission or any state securities agency to register or qualify the PIPE Notes, the Conversion Shares, the PIPE Warrants, or any shares issuable pursuant to the PIPE Warrants (the "Warrant Shares"). The Conversion Shares and Warrant Shares when issued will be deemed restricted securities and bear appropriate legends.
- § The terms and conditions of the PIPE Warrants, to the extent not expressly amended in the Second Modification Agreement, shall remain in full force and effect in furtherance of the terms and conditions set forth in the Modification Agreement.

Payment of \$200,000 was made by the Company in accordance with the Second Modification Agreement, the Original Notes were surrendered by the Investors and 1,060,000 shares of common stock were issued to the Investors on December 27, 2007. Included in interest expense is the excess of the cost to settle the obligation over the carrying value at the settlement date totaling \$222,368.

The aggregate value of the 2007 PIPE warrants in connection with the Second Modification Agreement were valued at \$116,913 using the Black-Scholes valuation model with the following assumptions: risk-free interest rate of 4.39%; dividend yield of 0%; volatility factors of the expected market price of common stock of 116.75%; and an expected life of five years (statutory term). The Company recorded and issued these warrants in January 2008.

7. Capital stock

As of June 30, 2008, the Company has authorized 200,000,000 shares of its common stock, of which 57,751,669 shares were issued and outstanding.

In September 2006, the Company entered into an equity arrangement with an investment banking firm. Under the arrangement the Company may sell (put) shares of common stock from time to time over a 36-month period, at a purchase price calculated at 97% of the lowest best closing bid for the Company's common stock for the five trading days following the put notice for cash. The Company may draw up to \$10,000,000. Because the price of the common stock fluctuates, the number of shares of common stock that the Company may issue when the Company exercises the put rights will vary, the Company does not know how many shares will actually be issued under the put. On October 6, 2006, the Company filed a Registration Statement which was effective October 30, 2006 which registered and made available 7,000,000 shares of common stock for possible future draws under the line of credit.

During the year ended December 31, 2007 the Company drew down \$ 992,055 (\$912,683 net of closing costs) and issued 1,880,421 shares of common stock. As of June 30, 2008 the Company has drawn down \$1,372,150 (\$1,262,378) net of closing costs) of this commitment and issued 2,367,905 shares at an average price of \$0.58 per share, leaving 4,632,095 shares available under the equity line of credit.

In August 2007, the Company issued 2,597,524 shares in connection with the exercise of options that were originally granted to the late Edward L. Masry.

During the year ended December 31, 2007, the Company issued 1,910,711 shares of common stock in exchange for conversion of \$526,480 of Convertible Notes

During the six months ended June 30, 2008, the Company issued 7,421,896 shares of common stock in exchange for \$1,855,474 conversion of Convertible Notes and settlement of loan and payable in accordance with the Morale Orchards-Matthews Modification

Agreement. The Company incurred and recorded additional non-cash interest and legal expense in the amount of \$928,237.

During the six months ended June 30, 2008, the Company issued 2,620,860 shares of common stock in exchange for conversion of \$1,067,000 of other Convertible Notes.

During the six months ended June 30, 2008, the Company issued 7,838 shares of common stock in exchange for consulting services in the amount of \$2,900. Also during the six months ended June 30, 2008, the Company issued 10,000 shares of common stock for shares issuable related to consulting services recorded in 2007.

During the six months ended June 30, 2008, the Company issued 156,012 shares of common stock for settlement of \$48,979 in payables.

During the six months ended June 30, 2008, the Company issued 661,660 shares of common stock for exercise of warrants for which the Company received \$330,830.

8. Stock options and warrants

Options

The Company currently issues stock options to employees, directors and consultants under the 2004 Stock Plan (the "Plan"). As of December 31, 2005, the Company could issue options under the Plan to acquire up to 5,000,000 shares of common stock. In February 2006, the board approved an amendment to the Plan, increasing the authorized shares by 2,000,000 shares to 7,000,000 shares. At June 30, 2008, 4,734,604 shares of common stock were available to be granted under the Plan. Prior to 2004, the Company granted to officers of the Company outside the Plan options to purchase 3,250,000 options outside the Plan to officers of the Company of which 250,000 are still outstanding.

Employee options vest according to the terms of the specific grant and expire from 5 to 10 years from date of grant. Non-employee option grants to date are vested upon issuance. The weighted-average, remaining contractual life of employee options outstanding at June 30, 2008 and December 31, 2007 was 6.5 years and 7.1 years, respectively. Stock option activity for the six months ended June 30, 2008 and the year ended December 31, 2007 was as follows, which includes 250,000 options granted outside the Plan:

	Weighted Avg. Options	Weighted Avg. Exercise Price
Options, January 1, 2004	13,250,000	0.11
Options granted	1,172,652	1.03
Options exercised	—	—
Options cancelled	—	—
Options, December 31, 2004	14,422,652	0.18
Options granted	2,085,909	0.92
Options exercised	—	—
Options cancelled	(10,000,000)	0.10
Options, December 31, 2005	6,508,561	0.53
Options granted	1,313,605	1.21
Options exercised	(2,860,000)	0.10
Options forfeited	(962,607)	0.84
Options cancelled	—	—
Options, December 31, 2006	3,999,559	0.99
Options granted	238,679	0.55
Options exercised	—	—
Options forfeited	(49,793)	1.96
Options cancelled	—	—
Options, December 31, 2007	4,188,445	\$ 0.95
Options granted (unaudited)	—	—
Options exercised (unaudited)	—	—
Options forfeited (unaudited)	(2,287,220)	1.00
Options cancelled (unaudited)	—	—
Options, June 30, 2008 (unaudited)	<u>1,901,225</u>	<u>\$ 0.89</u>



During the six months ended June 30, 2008, no options were granted.

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
<i>As of June 30, 2008:</i>			
Options Outstanding	1,901,225	\$ 0.89	6.50
Options Unvested	188,679	\$ 0.53	9.07
Options Exercisable	1,712,546	\$ 0.93	6.22

As of June 30, 2008, the exercise price of all options outstanding exceeds the market price of the Company's stock, and therefore there was no intrinsic value. The total deferred compensation expense on the outstanding value of unvested options at June 30, 2008 is \$5,453, which will be recognized over a weighted average period of 12 months.

Stock-based compensation during the six month period ended June 30, 2008 was \$43,636, compared to \$25,200 for the six month period ended June 30, 2007.

Warrants

The following table summarizes certain information about the Company's stock purchase warrants.

	Warrants	Weighted Avg. Exercise Price
Warrants outstanding, January 1, 2004	14,252,414	0.48
Warrants granted	2,372,500	1.27
Warrants exercised	(960,500)	0.20
Warrants cancelled	—	—
Warrants outstanding, December 31, 2004	15,664,414	0.62
Warrants granted	5,198,574	1.16
Warrants exercised	(50,500)	0.99
Warrants cancelled	(20,000)	1.50
Warrants outstanding, December 31, 2005	20,792,488	0.75
Warrants granted	3,624,894	1.28
Warrants exercised	(2,328,452)	0.68
Warrants cancelled	(1,191,619)	1.46
Warrants outstanding, December 31, 2006	20,897,311	\$ 0.81
Warrants granted	3,602,701	0.64
Warrants exercised	—	—
Warrants cancelled	(6,580,984)	1.06
Warrants outstanding, December 31, 2007	17,919,028	\$ 0.67
Warrants granted	1,015,975	0.48
Warrants exercised	(1,064,650)	0.50
Warrants cancelled	(4,551,333)	0.63
Warrants outstanding, June 30, 2008	13,319,020	\$ 0.68

9. Research and development

The Company has a research and development facility in Morgan Hill, California. The Company has expanded the research and development to include application of the ZEFs, MK IV, CAT-MATE and ELECTRA technologies for diesel engines, motorbikes, boats, generators, lawnmowers and other small engines. The Company has purchased test vehicles, test engines and testing equipment. The Company has completed testing on products incorporating its ZEFs, MK IV and CAT-MATE technologies for multiple automobiles, trucks, motorcycles, off-road vehicles and stationary engines. The Company has entered into a Research & Development Agreement with Temple University in connection with the ELECTRA technology. The Company spent \$316,750 and \$277,500 for the six months ended June 30, 2008 and 2007, respectively.

10. Commitments and contingencies

Patent Infringement Claims by Jeffrey A. Muller

In April 2005, Jeffrey A. Muller, the Company's former sole director and executive officer, filed a complaint against the Company in the Federal District Court for the Central District of California, seeking declaratory and injunctive relief and alleging unfair competition in connection with a claimed prior patent interest in the ZEFS device and stock option rights. In seeking declaratory relief, Mr. Muller is seeking to have the patent rights in the ZEFS device that were previously transferred to the Company by Mr. Muller's bankruptcy trustee declared null and void.

This lawsuit brought by Mr. Muller arose out of the same claims that were the subject of litigation in the Federal District Court for the Southern District of New York, in which the Court entered judgment against Mr. Muller. Those claims are pending further proceedings. While the Company believes that the Company has valid claims and defenses, there can be no assurance that an adverse result or outcome on the pending motions or a trial of this case would not have a material adverse effect on the Company's financial position or cash flow.

Litigation Involving Scottish Glen Golf Company

We are involved in litigation with Scottish Glen Golf Company, Inc. (SGGC) doing business as KZ Golf, Inc., the Company's previous landlord on claims in the aggregate amount of \$104,413. STWA does not dispute the fact that certain amounts of unpaid past rent are due but does dispute that it owes the aggregate of \$104,413 demanded by SGGC; more than half of which are purported "late fees" which was assessed at the rate of \$100 per day. It is the company's position that the late fees are void and unenforceable and that STWA is entitled to a set-off for office space that reverted back to SGGC.

While the Company believes that it has valid claims and defenses, given the inherent uncertainties of litigation, the Company cannot predict the outcome of this matter. Accordingly, there can be no assurance that an adverse result or outcome of this matter would not have a material adverse effect on the Company's financial position or cash flow. The Company believes that these claims arose from acts of a related party involving a former officer and director and his wife as a beneficial owners of SGGC.

Effective April 30, 2008 the Company and Scottish Glen Golf Company, Inc., dba KZG settled their pending litigation relating to the Company's prior offices. In the interest of avoiding further litigation costs and expenses, the Company and SGGC executed a "Settlement and Mutual Release Agreement effective April 30, 2008. The Company will pay SGGC the sum of \$75,000, execution of which is hereby stayed pending the following terms:

- a. Company shall pay to SGGC the sum of \$51,000 in two installments, without interest, as follows:
 - (1) \$34,000 due on or before June 2, 2008 and
 - (2) \$17,000 due on or before July 17, 2008
- b. The above payments shall be payable to SCOTTICH GLEN GOLF COMPANY, INC. dba KZG and wired transferred to the latter.
- c. In the event any payment listed above is not paid when due, then the total sum of \$75,000 shall immediately be due and owing, less any payments actually made pursuant to the Agreement and SGGC shall be entitled to file the Stipulated Judgment
- d. The Settlement and Mutual Release Agreement also provides for mutual general releases.

Upon full and complete execution of all duties and obligations by Company under the terms of this Agreement, and provided Paragraph c. above has not occurred, SGGC shall cause the Complaint to be dismissed, with prejudice, as to all causes of action and as to all parties. The Company has recorded the accrued liability at June 30, 2008. (See "Item 5-Other Information.")

Employment agreement

Effective July 18, 2007, the Company entered into an employment agreement with Mr. Charles R. Blum to serve as the Company's President and Chief Executive Officer. Pursuant to the Employment Agreement, Mr. Blum's employment is for a one-year term, subject to automatic one-year extensions and provides for annual base compensation of \$200,000 per year, subject to periodic review and adjustment. In addition, Mr. Blum will receive an automobile allowance of \$900 per month and four weeks of paid vacation annually. Also, Mr. Blum is entitled to participate in all employee benefit plans that the Company makes available to the Company's employees generally; provided that if Mr. Blum elects not to participate in the Company's group medical insurance plan, Mr. Blum will be reimbursed in an amount equal to the lesser of (i) the premium the Company would have paid to include Mr. Blum as a participant in that group health insurance plan and (ii) the sums paid by Mr. Blum in connection with maintaining Mr. Blum's private health insurance. The Company will also reimburse Mr. Blum the reasonable costs paid by Mr. Blum for maintaining DSL Internet access and other direct costs of maintaining an office at Mr. Blum's home, but only until such time as the Company shall provide Mr. Blum with an office at a location reasonably acceptable to Mr. Blum.

Minimum guaranteed compensation payments under Mr. Blum's employment agreement amounts to approximately \$21,000 for the year 2008.

As of December 31:

<u>Year</u>	
2008	\$ 21,000
2009	\$ 0
Total	<u>\$ 21,000</u>

During the six months ended June 30, 2008, approximately \$100,000 was paid for employment agreement.

Consulting agreements

On January 4, 2007, the Company entered into a Consulting Agreement (the “Consulting Agreement”) with Spencer Clarke LLC (“Spencer Clarke”) pursuant to which Spencer Clarke has agreed that for a twelve-month period beginning January 4, 2007, Spencer Clarke will provide the Company with financial consulting services (including but not limited to executive search, strategic partnerships, research on new markets, strategic visibility, etc) to help further develop the Company’s strategic business plan.

For Spencer Clarke’s services the Company has agreed to pay Spencer Clarke a nonrefundable fee of \$20,000 per month, payable in advance. The first payment, in the amount of \$60,000 and covering three months, was due by the Company on March 1, 2007. No payments have been made under this agreement. The Company will also reimburse Spencer Clarke for expenses it incurs in connection with the performance of its services under the Consulting Agreement, provided that expenses in excess of \$2,000 require the Company’s prior approval before such expenses may be incurred by Spencer Clarke.

On December 13, 2007, the Company entered into an agreement with a consultant to provide financial and marketing services. Compensation is to be paid on an hourly rate, half in cash and half in the Company’s common stock to be issued on the first day of the second month after services are provided.

On December 13, 2007, the Company entered into an agreement with a consultant to provide coordination services with various governmental agencies, in California for a fee of \$2,500 plus 10,000 shares of the Company’s common stock.

Leases

In September 2005, the Company entered into a lease agreement for a testing facility located in Morgan Hill, California. The term of the lease was from September 1, 2005 through August 31, 2007 and carried an option to renew for two additional years at the then prevailing market rate. The rent was \$2,240 per month under this lease. The lease was amended in February 2006 for additional space. The rent under the amended lease was \$4,160 per month. The Company renewed this lease on August 9, 2007 for an additional two-year term. The rent is \$4,640 per month for the first six months of the new term of the lease and \$5,480 per month for the remaining eighteen months of the new term of the lease.

In May 2008, the Company entered into a lease agreement for its administrative offices in Los Angeles, California. The term of the lease was for \$3,000 per month from June 1, 2008 through November 30, 2008. From that point on, the lease is due on a month to month basis with rent payment increasing to \$3,750.

Total rent expense under this lease for the six-month period ended June 30, 2008 and 2007, is \$34,200 and \$27,840, respectively. The following is a schedule by years of future minimum rental payments required under the non-cancellable operating lease as of June 30, 2008.

2008	\$	47,880
2009		<u>43,840</u>
Total	\$	<u>91,720</u>

Item 2. Management's Discussion and Analysis or Plan of Operations

This Quarterly Report on Form 10-QSB contains forward-looking statements. These forward-looking statements include predictions regarding our future:

- revenues and profits;
- customers;
- research and development expenses and efforts;
- scientific and other third-party test results;
- sales and marketing expenses and efforts;
- liquidity and sufficiency of existing cash;
- technology and products;
- the outcome of pending or threatened litigation; and
- the effect of recent accounting pronouncements on our financial condition and results of operations

You can identify these and other forward-looking statements by the use of words such as "may," "will," "expects," "anticipates," "believes," "estimates," "continues," or the negative of such terms, or other comparable terminology.

Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements.

Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under the heading "Risk Factors" in our Annual Report on Form 10-KSB for the year ended December 31, 2007. All forward-looking statements included in this document are based on information available to us on the date hereof. We assume no obligation to update any forward-looking statements.

Overview

The following discussion and analysis of our condensed consolidated financial condition and condensed consolidated results of operations should be read in conjunction with the condensed consolidated financial statements and notes thereto included in Part I, Item 1 of this Form 10-QSB and the condensed consolidated financial statements and notes thereto contained in our Annual Report on Form 10-KSB for the fiscal year ended December 31, 2007.

We are a green technology company that leverages a suite of patented, patent-pending and licensed intellectual properties related to the treatment of fuels. Technologies patented by, or licensed to, us utilize either magnetic or uniform electrical fields to alter physical characteristics of fuels and are designed to create a cleaner combustion. Cleaner combustion has been shown to improve performance, enhance fuel economy and/or reduce harmful emissions in laboratory testing.

Our ECO ChargR™ and MAG ChargR™ products use fixed magnetic fields to alter some physical properties of fuel, by incorporating our patented and patent-pending ZEFS and MK IV technologies. We differentiate ECO ChargR and MAG ChargR products based on their differing attributes and marketing focus. ECO ChargR products are primarily designed to reduce harmful emissions and MAG ChargR products are primarily designed to enhance performance and fuel economy. Our ECO ChargR product is intended to reduce exhaust emissions in vehicle and small utility motors. ECO ChargR will be marketed primarily to original equipment manufacturers ("OEMs") as well as to pilot and government-mandated emissions programs. Our MAG ChargR product is intended to increase power and improve mileage. MAG ChargR will be marketed primarily to the specialty consumer accessories market for many types of vehicles, including but not limited to cars, trucks, motorcycles, scooters, all terrain vehicles ("ATVs"), snowmobiles, personal watercraft and small utility motors. On the other hand, because our ECO ChargR and MAG ChargR products are customized to specific brands, models and engine sizes, these products ultimately will require hundreds of individually developed parts, which can be expensive and time-consuming to produce. See "Our Technologies and Products" below.

Our first revenues have come from initial sales in Asia for our ECO ChargR product in the motorcycle industry. We plan on commencing sales of ECO ChargR to customers in the United States in the motorcycle industry in third quarter of 2008. We also plan on commencing initial sales of our MAG ChargR product in Asia and the United States in the automobile and motorcycle industry in the third quarter of 2008. See "Recent Developments" and "Sales and Marketing" below.

We have obtained a license from Temple University for their patent-pending uniform electric field technology, tentatively called ELEKTRA™. The ELEKTRA technology consists of passing fuel through a specific strong electrical field. Although ELEKTRA has a similar effect on fuels as our ZEFS and MK IV technologies, ELEKTRA incorporates a uniform electrical field principle. Based on our early research and product development, we believe that ELEKTRA carries certain advantages over our ZEFS and MK IV technologies, primarily not requiring

as many variations for products incorporating the ELEKTRA technology compared to products incorporating the ZEFS or MK IV technologies. Preliminary testing conducted in Europe by an outside research and development facility indicates that ELEKTRA causes a significant change in some of the physical characteristics of the fuel, resulting in better atomization of the fuel and improved combustion.

We have also entered into a research and development agreement with Temple University to conduct further research on the ELEKTRA technology and magnetic technologies in general. Together with Temple University, we have developed prototype products using the ELEKTRA technology and we are continuing testing, and research and development. We are in the early stages of developing ELEKTRA products that, based on the previously mentioned preliminary testing, is intended to improve fuel economy and change fuel viscosity, and may improve performance and reduce emissions, depending upon the specific application. We are also working with Temple and several domestic and international corporations investigating applications of this technology to the transportation industry, oil refineries and pipelines, and OEMs. See "Our Technologies and Products" below.

We operate in a highly competitive industry. Many of our activities may be subject to governmental regulation. We have taken aggressive steps to protect our intellectual property.

There are significant risks associated with our business, our company and our stock.

We are a development stage company that generated its first initial revenues in the fourth quarter of 2006. Our expenses to date have been funded primarily through the sale of stock and convertible debt, as well as proceeds from the exercise of stock purchase warrants. We raised capital in 2007 and will need to raise substantial additional capital in 2008, and possibly beyond, to fund our sales and marketing efforts, continuing research and development, and certain other expenses, until our revenue base grows sufficiently.

Our company was incorporated on February 18, 1998, as a Nevada corporation, under the name Mandalay Capital Corporation. We changed our name to Save the World Air, Inc. on February 11, 1999, following the acquisition of marketing and manufacturing rights of the ZEPS technologies. Our mailing address is 235 Tennant Avenue, Morgan Hill, California 95037. Our telephone number is (408)-778-0101. Our corporate website is www.stwa.com. Information contained on the website is not deemed part of this Annual Report.

Our common stock is quoted on the Over-the-Counter Bulletin Board under the symbol "ZERO.OB".

Results of Operations

We did not generate any revenue for the three-month period ended June 30, 2008 and 2007. Revenues for the six-month period ended June 30, 2008 were \$0 compared with revenues of \$22,000 and cost of goods sold of \$5,360 for the six-month period ended June 30, 2007.

Operating expenses were \$519,860 for the three-month period ended June 30, 2008, compared to \$1,023,787 for the three-month period ended June 30, 2007, a decrease of \$503,927. This decrease is attributable to decreases in cash expenses of \$470,293 and non-cash expenses of \$33,634. Specifically, the cash expense decrease is attributable to decreases in salaries and benefits (\$172,437), consulting and professional fees (\$184,049), office and other expenses (\$43,686), corporate expenses (\$43,144), travel expenses (\$18,310) and exhibits and trade shows (\$8,667). The decrease in non-cash expense is primarily attributable to a decrease in depreciation (\$47,054) offset by an increase in the fair value of options given to employees (\$13,420).

Operating expenses were \$1,280,002 for the six-month period ended June 30, 2008, compared to \$2,303,562 for the six-month period ended June 30, 2007, a decrease of \$1,023,560. This decrease is attributable to a decrease in cash expenses of \$1,189,860, offset by an increase in non-cash expenses of \$166,300. The decrease in cash expenses is attributable to decreases in consulting and professional fees (\$463,695), salaries and benefits (\$392,725), office and other expenses (\$156,275), travel expenses (\$93,866), corporate expenses (\$50,071) and exhibits and trade shows (\$33,228). The non-cash increase is attributable to an increase in non-cash legal fees (\$236,572), fair value of options and warrants given to employees and consultant (\$18,936), bad debt (\$1,380) offset by a decrease in depreciation (\$90,588).

Research and development expenses were \$62,692 for the three-month period ended June 30, 2008, compared to \$100,731 for the three-month period ended June 30, 2007, a decrease of \$38,039. This decrease is mainly attributable decrease in product testing, research and supplies (\$45,039) offset by an increase in contract fees (\$6,000).

Research and development expenses were \$322,362 for the six-month period ended June 30, 2008, compared to \$441,183 for the six-month period ended June 30, 2007, a decrease of \$118,821. This decrease is attributable to decreases in product testing, research and supplies (\$133,720), consulting fees (\$16,097), travel and related expenses (\$8,254) offset by an increase in contract fees (\$39,250).

Other expense for the three-month period ended June 30, 2008 were \$109,475, compared to \$403,665 for the three-month period ended June 30, 2007, a decrease of \$294,190. This decrease is attributable to a decrease in non-cash interest expense (\$236,104), cash interest expense (\$6,129), and increase in other income (\$51,957).

Other expense for the six-month period ended June 30, 2008 were \$1,373,510, compared to \$713,439 for the six-month period ended June 30, 2007, an increase of \$660,071. This increase is attributable to increases in non-cash interest expense (\$749,804) and loss on sale of equipment (\$9,683), offset by decrease in cash interest expense (\$47,009) and increase in other income (\$52,407).

We had a net loss of \$692,027, or \$0.02 per share, for the three-month period ended June 30, 2008, compared to a net loss of \$1,528,183, or \$0.04 per share, for the three-month period ended June 30, 2007. We had a net loss of \$2,975,874, or \$0.06 per share, for the six-month period ended June 30, 2008, compared to a net loss of \$3,442,344, or \$0.09 per share, for the six-month period ended June 30, 2007. We expect to incur additional net loss in the fiscal year ending December 31, 2008, primarily attributable to continued operating and marketing-related expenditures without the benefit of any significant revenue for the remainder of the year.

Liquidity and Capital Resources

General

We have incurred negative cash flow from operations in the developmental stage since our inception in 1998. As of June 30, 2008, we have been funded primarily through the sale of convertible notes and issuance of our stock upon exercise of warrants.

The condensed consolidated financial statements accompanying this Quarterly Report have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of our business. As reflected in the accompanying condensed consolidated financial statements, we had a net loss of \$2,975,874 and a negative cash flow from operations of \$1,124,508 for the six months ended June 30, 2008, and a stockholders' deficiency of \$2,513,664 as of June 30, 2008. These factors raise substantial doubt about our ability to continue as a going concern. Our ability to continue as a going concern is dependent on our ability to raise additional funds, generate revenue and implement our business plan. The financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern.

Our current liabilities greatly exceed our assets and we are unable to meet our obligations as they become due. We face significant challenges in generating revenue and maintaining adequate working capital during the remainder of 2008 as a result of several factors. Among other things, to date our distributors, primarily located in Asia, have placed fewer orders than we had expected them to place under the terms of our distribution agreements with them. This resulted in our having less revenue and therefore less working capital available for the further development of our business at a time when the operating costs of our business have been increasing. We will require significant additional outside capital during 2008 in order to meet all of our obligations, produce products for sale and ship such products.

Details of Recent Financing Transactions

Equity Arrangement

In September 2006, the Company entered into what is sometimes termed an equity arrangement with an investment banking firm. Under the arrangement the Company may sell (put) shares of common stock from time to time over a 36-month period, at a purchase price calculated at 97% of the lowest best closing bid for the Company's common stock for the five trading days following the put notice. The Company may draw up to \$10,000,000. Because the price of the common stock fluctuates and the number of shares of common stock that the Company may issue when the Company exercises the put will vary, the Company does not know how many shares, if any, will actually issue under the put. On October 6, 2006, the Company filed a Registration Statement which was effective October 30, 2006 which registered and made available 7,000,000 shares of common stock for possible future draws under the arrangement.

As of June 30, 2008 the Company has drawn down \$1,372,150 (\$1,262,378 net of closing costs) of this commitment and issued 2,367,905 shares of common stock, leaving 4,632,095 shares of common stock still available under the equity arrangement.

Morale Orchards, LLC

On December 5, 2006, the Company entered into a Note Purchase Agreement (the "Note Purchase Agreement") with Morale, pursuant to which Morale purchased from the Company two (2) Convertible Promissory Notes, one dated December 5, 2006 (the "2006 Morale Note"), in the principal face amount of \$612,500, and another, dated January 10, 2007 (the "2007 Morale Note"), also in the principal face amount of \$612,500 (collectively, the "Morale Notes"), and two (2) warrants, one accompanying the 2006 Morale Note, and the other accompanying the 2007 Morale Note. Each warrant provides Morale the right to purchase shares of common stock of the Company. The aggregate purchase price for the Morale Notes and Morale Warrants was \$1,000,000, of which \$500,000 was paid by Morale and received by the Company on or about December 5, 2006, and of which \$500,000 was paid by Morale and received by the Company on or about January 10, 2007;

The 2006 Morale Note is convertible at the rate of \$0.85 per share into 720,588 shares of the Company's common stock, and the 2007 Morale Note is convertible at the rate of \$0.70 per share into 875,000 shares of the Company's common stock;

The 2006 Morale Warrant is exercisable at \$0.85 per share for 360,294 shares of the Company's common stock, and the 2007 Morale Warrant is exercisable at \$.70 per share for 437,500 shares of the Company's common stock.

The Note Purchase Agreement provides, in pertinent part, that in the event the Company has not repaid each of the Morale Notes in full by the anniversary date of their issuances, the principal balances of each note shall be increased by ten percent (10%) and the Company shall pay interest at two and one-half percent (2½%) per month, compounded daily, for each month until each of the Morale Notes is paid in full.

Morale has piggy-back registration rights pursuant to which Morale may require the Company to include the shares of the Company's common stock issuable upon conversion of the Morale Notes and exercise of the Morale Warrants in certain future registration statements the Company may elect to file.

The aggregate value of the Morale Warrants issued in connection with the January 10, 2007 purchase were valued at \$118,955 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 4.68%; dividend yield of 0%; volatility factors of the expected market price of common stock of 245%; and an expected life of five years (statutory term) and vest over 180 days. The Company also determined that the notes contained a beneficial conversion feature of \$231,455. The value of the Morale Warrants of \$118,955, the conversion option of \$231,455 and the transaction fees of \$112,500 are considered as debt discount and are being amortized over the life of the Note

As of January 31, 2008, both the 2006 and 2007 Morale Notes were in default, and neither of the Morale Notes nor the Morale Warrants have been converted into shares of common stock of the Company. The amount due and owing as of January 31, 2008, under the 2006 Morale Note is \$689,327. The amount due and owing as of January 31, 2008, under the 2007 Morale Note is \$672,885.

The Company borrowed the principal sum of \$20,000 from Morale on October 30, 2007, at an interest rate of ten percent (10%) per annum. Principal and accrued interest under the Morale Note is due on demand, and no payments there under have been made by the Company.

Morale is beneficially owned by Jacqueline Alexander, who is the wife of Leodis Matthews, who, through his law firm, the Matthews Law Firm, serves as outside legal counsel to the Company. The Company is indebted to the Matthews Law Firm for unpaid legal fees and costs through January 31, 2008, in the aggregate amount of \$472,762.

The Company, Morale and the Matthews Law Firm now desire to modify the terms and provisions of, and to provide for the satisfaction of the Company's obligations under, the Morale Notes, the Additional Morale Note and the Matthews Law Firm Debt, pursuant to the terms and conditions set forth in this Modification and Satisfaction Agreement.

The Company, Morale and the Matthew Law Firm agreed to the following:

1. Waiver of Interest.

- (i) Morale agrees to forgive and waive any and all accrued interest on the Morale Notes from and after January 31, 2008;
- (ii) Morale agrees to forgive and waive any and all accrued interest due on the Additional Morale Note from the date of its issuance; and the Matthews Law Firm agrees to forgive any and all interest which may have accrued on the Matthews Law Firm Debt.

2. Cancellation of Notes, Debt and Obligations. Upon the execution of this Modification and Satisfaction Agreement, the 2006 Morale Note, the 2007 Morale Note, the Additional Morale Note, the Unpaid 2006 Morale Note Debt, the Unpaid 2007 Morale Note Debt, the Unpaid Additional Morale Note Debt and the Matthews Law Firm Debt, shall all be cancelled, be deemed satisfied in full and be of no further force or effect, effective January 31, 2008.

3. No Registration Rights. Upon execution hereof, the Morale Registration Rights shall be cancelled and be of no further force or effect.

4. Issuance of Shares. In consideration of this Modification and Satisfaction Agreement, including the waivers and cancellations as set forth in paragraphs 1 and 2, above, upon execution hereof, and concurrently with the waivers and cancellations provided hereunder, the Company shall issue a total of 7,421,896 shares of its common stock to Morale and the Matthews Law Firm, allocable as follows: (i) 2,759,308 shares shall be issued to Morale arising out of and in exchange for cancellation of the 2006 Morale Note and the Unpaid 2006 Morale Note Debt; (ii) 2,691,540 shares shall be issued to Morale arising out of and in exchange for cancellation of the 2007 Morale Note and the Unpaid 2007 Morale Note Debt; (iii) 80,000 shares shall be issued to Morale arising out of and in exchange for cancellation of the Additional Morale Note and the Unpaid Additional Morale Note Debt; and (iv) 1,891,048 shares shall be issued to the Matthews Law Firm arising out of and in exchange for cancellation of the Matthews Law Firm Debt. The Company shall not be required to, and shall not, file a Registration Statement with the Securities and Exchange Commission or any state securities agency to register or qualify the shares of common stock of the Company issuable to Morale and the Matthews Law Firm hereunder, and all such shares when issued shall be deemed restrictive securities and bear appropriate legends.

5. Morale Warrants. The terms and conditions of the Morale Warrants, to the extent not expressly amended in this Modification and Satisfaction Agreement, shall remain in full force and effect.

On March 10, 2008, 80,000 shares of the Company's common stock were issued to Morale Orchards, LLP, in cancellation of a note payable in the amount of \$20,000 as part of the Modification Agreement entered into on January 31, 2008 between the Company and Morale Orchards, LLP and Matthews & Partners.

On March 10, 2008, 5,450,848 shares of the Company's common stock were issued to Morale Orchards, LLP, in conversion and cancellation of the Convertible Notes issued December 5, 2006 and January 10, 2007 in the amount of \$1,362,712 as part of the Modification Agreement entered into on January 31, 2008 between the Company and Morale Orchards, LLP and Matthews & Partners.

On March 10, 2008, 1,891,048 shares of the Company's common stock were issued to Leodis C. Matthews, APC, in cancellation of accrued professional fees in the amount of \$472,762 as part of the Modification Agreement entered into on January 31, 2008 between the Company and Morale Orchards, LLP and Matthews & Partners.

As a result of the debt cancelled and shares of common stock issued in connection with the Modification Agreement, the Company incurred non-cash interest expense of \$691,665 and non-cash legal expense of \$236,572 which was recorded in the first quarter of 2008.

2007 PIPE Offering. During the year ended December 31, 2007, the Company conducted an offering (the "2007 PIPE Offering"), through Spencer Clarke LLC, as exclusive placement agent, of up to \$2,000,000 principal amount of its 10% convertible notes (the "2007 PIPE Notes"). Interest on the 2007 PIPE Notes, at a rate of 10% per annum, is payable quarterly. The Notes are due nine months from date of issuance. The 2007 PIPE Notes are convertible into shares of common stock at an initial conversion price of \$0.70 per share (the "Conversion Shares"). There is no reset to the conversion price for any beneficial conversion feature.

The Company has the right to redeem any or all of the outstanding 2007 PIPE Notes in its sole discretion anytime after the termination of the 2007 PIPE Offering and prior to the maturity date of the 2007 PIPE Notes. The redemption price shall be the face amount of the redeemed 2007 PIPE Notes plus accrued and unpaid interest thereon. Subject to the following sentence, at any time prior to the maturity date of the 2007 PIPE Notes, for each additional \$1,000,000 of gross proceeds raised from one or more offerings of the Company's equity or quasi-equity securities, the Company shall redeem 2007 PIPE Notes with a minimum face value of \$500,000 together with accrued and unpaid interest, until the entire outstanding 2007 PIPE Note is redeemed. Certain financings that the Company may conduct outside of North America are exempt from this provision to redeem the 2007 PIPE Notes in whole or in part.

Investors in the 2007 PIPE Offering also received a warrant (the "2007 PIPE Warrant"), entitling the holder to purchase a number of shares of the Company's common stock equal to 150% of the number of shares of common stock into which the 2007 PIPE Notes are convertible (the "Warrant Shares"). The 2007 PIPE Warrant will be exercisable on a cash basis only and will have registration rights. The 2007 PIPE Warrant is exercisable at an initial price of \$1.00 per share, and is exercisable immediately upon issuance and for a period of three years from the date of issuance.

Promptly, but no later than 90 days following the closing date of the 2007 PIPE Offering, the Company is required to file a Registration Statement with the SEC to register the Conversion Shares and the Warrant Shares. The Company shall use its best efforts to ensure that such Registration Statement is declared effective within 120 days after filing.

Pursuant to the terms of the PIPE Notes, if a Registration Statement is not filed on the 91st day following the closing date, (i) the interest rate on the PIPE Notes increased from 10% to 18% per annum until the event of default is cured and (ii) the holders of the PIPE Notes became entitled to receive additional warrants in an amount equal to 25% of the PIPE Warrants originally issued, for each 60-day period that the Company remains in default.

During the year ended December 31, 2007, the Company issued \$400,000 of the PIPE Notes which could be converted into 571,429 shares of the Company's common stock and 2007 PIPE Warrants to purchase 857,144 shares of the Company's common stock. These warrants expire March 1, March 30 and April 2, 2010 and are exercisable at a price of \$1.00 per share. The Company had related transaction fees of \$48,000, resulting in net proceeds to the Company of \$352,000. In addition to the transaction fees, warrants to purchase 57,143 shares of the Company's common stock were issued to Spencer Clarke LLC, the Company's exclusive placement agent for the 2007 PIPE Offering. These warrants expire March 1, March 30 and April 2, 2010 and are exercisable at a price of \$0.70 per share.

The aggregate value of the 2007 PIPE Warrants issued in connection with this offering and the warrants issued to the placement agent were valued at \$256,533 using the Black-Scholes option valuation model with the following assumptions: risk-free interest rate of 4.40% to 5.16%; dividend yield of 0%; volatility factors of the expected market price of common stock of 100.28% to 114.98%; and an expected life of two years (statutory term). The Company also determined that the notes contained a beneficial conversion feature of \$62,857.

The Company was unable to meet its obligations to file the Registration Statement required under the terms of the 2007 PIPE Offering in a timely manner. In early July 2007, the Company began discussions with Spencer Clarke, acting on behalf of the holders of the PIPE Notes and PIPE Warrants, for an extension of time to file the Registration Statement. Notwithstanding such discussions, Spencer Clarke issued a Notice of Default dated August 1, 2007 (the "Notice") to the Company for its failure to file the Registration Statement in a timely manner.

On August 29, 2007, the Company entered into a Modification Agreement with the 2007 PIPE note holders. The Modification Agreement was entered into as a result of negotiations between the Company and Spencer Clarke, LLC ("Spencer Clarke"), the Company's exclusive placement agent for the 2007 PIPE Offering, after the Company failed to file with the Securities and Exchange Commission (the "SEC") in a timely manner a Registration Statement to register the shares of the Company's common stock into which the PIPE Notes are convertible and for which the PIPE Warrants may be exercised.

Pursuant to the Modification Agreement, the parties have agreed as follows:

- § Promptly, but no later than November 30, 2007 (instead of on or before July 2, 2007), the Company shall file the Registration Statement with the SEC to register the Conversion Shares and the Warrant Shares.
- § Effective August 1, 2007, the interest rate on the PIPE Notes shall be increased from 10% per annum to 18% per annum until such time as the Registration Statement is declared effective by the SEC.

- § The price at which the PIPE Notes may be converted into Conversion Shares (the "Conversion Price") shall be reduced from \$0.70 to \$0.45 per share.
- § Each Investor shall receive, for no additional consideration, additional warrants ("Additional Warrants") in an amount equal to an additional 50% of the PIPE Warrants originally issued pursuant to the terms of the 2007 PIPE Offering. These Additional Warrants total 428,575 and shall have the same registration rights as are described in the Private Placement Memorandum dated January 12, 2007 (the "Offering Memorandum") used in connection with the 2007 PIPE Offering applicable to the PIPE Warrants; shall be exercisable immediately upon issuance; shall remain exercisable for a period of five years from the date of the Modification Agreement, on a cash basis only, at an initial exercise price of \$0.45 per share; and shall, in all other respects, have the same terms and conditions, and be in the same form, as the PIPE Warrants.
- § If the Company does not file the Registration Statement with the SEC by November 30, 2007, each Investor shall receive, for no additional consideration, warrants ("Delay Warrants") in an amount equal to an additional 50% of the PIPE Warrants originally issued pursuant to the terms of the Offering Memorandum. The Delay Warrants shall have the same registration rights as are described in the Offering Memorandum applicable to the PIPE Warrants; shall be exercisable immediately upon issuance; shall remain exercisable for a period of five years from the date of this Agreement, on a cash basis only, at an initial exercise price of \$0.45 per share; and shall, in all other respects, have the same terms and conditions, and be in the same form, as the PIPE Warrants.

The terms and conditions of the Offering Memorandum, the PIPE Notes and the PIPE Warrants, to the extent not expressly amended in the Modification Agreement, remain in full force and effect. The issuance of the Additional Warrants ("Delay Warrants"), if any, and the reduction of the Conversion Price of the PIPE Notes, has the potential to dilute the percentage ownership interest of the Company's existing shareholders.

The aggregate value of the 2007 PIPE Warrants issued in connection with this Modification Agreement were valued at \$138,107 using the Black-Scholes option valuation model with the following assumptions: risk-free interest rate of 4.43%; dividend yield of 0%; volatility factors of the expected market price of common stock of 113.55%; and an expected life of two years (statutory term).

On November 30, 2007, the Company and the Investors entered into the Second Modification Agreement and pursuant to this agreement have agreed as follows:

- § The Investors have agreed to forgive all accrued interest on their PIPE Notes, from the date of issuance thereof through December 14, 2007.
- § On December 14, 2007, the Company agreed to pay all Investors 50% of the principal amount of their original PIPE Notes which equals a total cash repayment of \$200,000. Additionally, in repayment of the other 50% of the principal amount of the original PIPE Notes, the Company, on December 14, 2007, agreed to issue to Investors a total of 1,060,000 shares of the Company's common stock (the "Conversion Shares").
- § Concurrently with the cash payment and the issuance of the Conversion Shares as noted in paragraph 2 above, the Investors agreed to deliver to the Company the original of the PIPE Notes, which will be marked and deemed cancelled and of no further force or effect.
- § In further consideration of the above terms and conditions, the Investors have agreed that the Company shall not be required to, and shall not, file a Registration Statement with the Securities and Exchange Commission or any state securities agency to register or qualify the PIPE Notes, the Conversion Shares, the PIPE Warrants, or any shares issuable pursuant to the PIPE Warrants (the "Warrant Shares"). The Conversion Shares and Warrant Shares when issued will be deemed restricted securities and bear appropriate legends.
- § The terms and conditions of the PIPE Warrants, to the extent not expressly amended in the Second Modification Agreement, shall remain in full force and effect in furtherance of the terms and conditions set forth in the Modification Agreement.

Payment of \$200,000 was made by the Company in accordance with the Second Modification Agreement, the Original Notes were surrendered by the Investors and 1,060,000 shares of common stock were issued to the Investors on December 27, 2007.

The aggregate value of the 2007 PIPE warrants in connection with the Second Modification Agreement were valued at \$116,913 using the Black-Scholes valuation model with the following assumptions: risk-free interest rate of 4.39%; dividend yield of 0%; volatility factors of the expected market price of common stock of 116.75%; and an expected life of five years (statutory term). The Company recorded and issued these warrants in January 2008.

2007 Spring Offering. From June 13, 2007 through June 26, 2007, the Company conducted a private offering (the "Spring 2007 Offering") of up to \$550,000 aggregate face amount of its convertible notes (the "Spring 2007 Notes") with a small number of accredited investors. Of this amount, \$451,000 aggregate face amount of the Spring 2007 Notes were sold for an aggregate purchase price of \$410,000 net proceeds. Therefore, while the stated interest rate on the Spring 2007 Notes is 0%, the implied interest rate on the Spring 2007 Notes is 10%. The Spring 2007 Notes mature on the first anniversary of their date of issuance. The Spring 2007 Notes are convertible, at the option of the noteholders, into shares of common stock of the Company (the "Conversion Shares") at an initial conversion price equal to the average of the closing bid price of the Company's common stock for the five trading days preceding the closing dates of the Spring 2007 Offering (the "Conversion Prices"). On the first closing, 1,002,941 Conversion Shares are issuable at Conversion Price of \$0.34 per share. On the second closing, 207,548 conversion shares are issuable at a conversion price of \$0.53 per share. The per share price of the Company's common stock on the Pink Sheets during this period ranged from a low bid price (intraday) of \$0.35 to a high bid price (intraday) of \$0.59.

Each of the investors in the Spring 2007 Offering also received a warrant (the "Spring 2007 Warrants"), entitling the holder to purchase a number of shares of the Company's common stock equal to 50% of the number of shares of common stock into which the Spring 2007 Notes are convertible (the "Warrant Shares"). Each Spring 2007 Warrant is exercisable on a cash basis only at an initial price of \$0.50 per share, and is exercisable immediately upon issuance and for a period of two years from the date of issuance. A total of 605,242 Warrant Shares were issued. As of June 30, 2008, investors have converted \$423,500 of the Convertible Notes into 1,158,602 shares of the Company's common stock. The outstanding balance at June 30, 2008 is \$27,500.

The aggregate value of the Spring 2007 Offering Warrants issued in connection with the June 13, 2007 closing were valued at \$59,296 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 5.11%; dividend yield of 0%; volatility factors of the expected market price of common stock of 113.56%; and an expected life of two years (statutory term) and vest immediately upon issuance. The Company also determined that the notes contained a beneficial conversion feature of \$119,472. The value of the Spring 2007 Offering Warrants of \$59,296, the conversion option of \$119,472, and the transaction fees of \$31,000 are considered as debt discount and are being amortized over the life of the Note.

The aggregate value of the Spring 2007 Offering Warrants issued in connection with the June 26, 2007 closing were valued at \$19,580 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 5.11%; dividend yield of 0%; volatility factors of the expected market price of common stock of 117.65%; and an expected life of two years (statutory term) and vest immediately upon issuance. The Company also determined that the notes contained a beneficial conversion feature of \$21,655. The value of the Spring 2007 Offering Warrants of \$19,580, the conversion option of \$21,655 and the transaction fees of \$112,500 are considered as debt discount and are being amortized over the life of the Note.

2007 Summer Offering. From August 8, 2007 through September 27, 2007, the Company conducted a private offering (the "Summer 2007 Offering") of up to \$330,000 aggregate face amount of its convertible notes (the "Summer 2007 Notes") with a small number of accredited investors. Of this amount, \$309,980 aggregate face amount of the Summer 2007 Notes were sold for an aggregate purchase price of \$281,800 net proceeds. While the stated interest rate on the Summer 2007 Notes is 0%, the implied interest rate on the Summer 2007 Notes is 10%. The Summer 2007 Notes mature on the first anniversary of their date of issuance. The Summer 2007 Notes are convertible, at the option of the noteholder, into shares of common stock of the Company (the "Conversion Shares") at a conversion price equal to the average of the closing bid price of the Company's common stock for the five trading days preceding the closing date of the Summer 2007 Offering (the "Conversion Prices"). Up to 837,784 Conversion Shares are issuable at a Conversion Price of \$0.37 per share.

Each of the investors in the Summer 2007 Offering also received a warrant (the "Summer 2007 Warrants"), entitling the holder to purchase a number of shares of the Company's common stock equal to 50% of the number of shares of common stock into which the Summer 2007 Notes are convertible (the "Warrant Shares"). Each Summer 2007 Warrant is exercisable on a cash basis only at a price of \$0.50 per share, and is exercisable for a period of two years from the date of issuance. A total of 418,892 Warrant Shares were issued. As of June 30, 2008, investors have converted \$260,480 of the Convertible Notes into 704,091 shares of the Company's common stock. The outstanding balance at June 30, 2008 is \$49,500.

The aggregate value of the Summer 2007 Offering Warrants issued in connection with the September 28, 2007 closing were valued at \$60,678 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 4.87%; dividend yield of 0%; volatility factors of the expected market price of common stock of 124.83%; and an expected life of two years (statutory term) and vest immediately upon issuance. The Company also determined that the notes contained a beneficial conversion feature of \$69,055. The value of the Summer 2007 Offering Warrants of \$60,678, the conversion option of \$69,055 and the transaction fees of \$28,180 are considered as debt discount and are being amortized over the life of the Note.

2007 Fall Offering. From November 14, 2007 through December 17, 2007, the Company conducted a private offering (the "Fall 2007 Offering") of up to \$1,100,000 aggregate face amount of its convertible notes (the "Fall 2007 Notes") with a small number of accredited investors. Of this amount, \$622,600 aggregate face amount of the Fall 2007 Notes were sold for an aggregate purchase price of \$566,000 net proceeds. While the stated interest rate on the Fall 2007 Notes is 0%, the implied interest rate on the Fall 2007 Notes is 10%. The Fall 2007 Notes mature on the first anniversary of their date of issuance. The Fall 2007 Notes are convertible, at the option of the noteholder, into shares of common stock of the Company (the "Conversion Shares") at a conversion price equal to the average of the closing bid price of the Company's common stock for the five trading days preceding the closing date of the Fall 2007 Offering (the "Conversion Prices"). Up to 1,596,410 Conversion Shares are issuable at a Conversion Price of \$0.39 per share.

Each of the investors in the Fall 2007 Offering also received a warrant (the "Fall 2007 Warrants"), entitling the holder to purchase a number of shares of the Company's common stock equal to 50% of the number of shares of common stock into which the (Fall 2007 Notes) are convertible (the "Warrant Shares"). Each Fall 2007 Warrant is exercisable on a cash basis only at a price of \$0.50 per share, and is exercisable for a period of two years from the date of issuance. Up to 796,205 Warrant Shares are initially issuable on exercise of the Fall 2007 Warrants.

The aggregate value of the Fall 2007 Offering Warrants issued in connection with the December 17, 2007 closing were valued at \$95,290 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 5.11%; dividend yield of 0%; volatility factors of the expected market price of common stock of 137.25%; and an expected life of two years (statutory term) and vest immediately upon issuance. The Company also determined that the notes contained a beneficial conversion feature of \$63,362. The value of the Fall 2007 Offering Warrants of \$95,290, the conversion option of \$63,362, and the transaction fees of \$56,600 are considered as debt discount and are being amortized over the life of the Note.

As of June 30, 2008, 863,078 shares of the Company's common stock were issued to noteholders in the 2007 Fall Offering who converted and cancelled Convertible Notes in the amount of \$336,800. The outstanding balance at June 30, 2008 is \$286,000.

2007-2008 Winter Offering. From December 27, 2007 to February 29, 2008 the Company conducted an offering (the "2008 Winter Offering") of up to \$1,000,000 aggregate face amount of its convertible notes (the "2008 Winter Notes") with a small number of accredited investors. Of this amount, \$521,400 aggregate face amount of the 2008 Winter Notes were sold for an aggregate purchase price of \$474,000 net proceeds. Therefore, while the stated interest rate on the 2008 Winter Notes is 0%, the implied interest rate on the 2008 Winter Notes is 10%. The 2008 Winter Notes mature on the first anniversary of their date of issuance. The 2008 Winter Notes are convertible, at the option of the noteholder, into shares of common stock of the Company (the "Conversion Shares") at a conversion price equal to the average of the closing bid price of the Company's common stock for the five trading days preceding the closing date of the 2008 Winter Offering (the "Conversion Price"). Up to \$1,042,800 Conversion Shares are issuable at a Conversion Price of \$0.50 per share.

Each of the investors in the 2008 Winter Offering received, for no additional consideration, a warrant (the "2008 Winter Warrants"), entitling the holder to purchase a number of shares of the Company's common stock equal to 50% of the number of shares of common stock into which the (2008 Winter Notes) are convertible (the "2008 Warrant Shares") Each 2008 Winter Warrant is exercisable on a cash basis only at a Price of \$0.50 per share, and is exercisable for a period of two years from the date of issuance. Up to 521,400 2008 Warrant Shares are initially issuable on exercise of the 2008 Winter Warrants. As of June 30, 2008, investors have converted \$372,900 of the Convertible Notes into 745,800 shares of the Company's common stock. The outstanding balance at June 30, 2008 is \$148,500.

2008 Spring Offering. On May 27, 2008, the Company made an offering (the "2008 Spring Offering") with a certain investor of which, \$66,000 face amount of the 2008 Spring Note was sold for \$60,000 net proceeds. Therefore, while the stated interest rate on the 2008 Spring Note is 0%, the implied interest rate on the 2008 Spring Note is 10%. The 2008 Spring Note will mature on the first anniversary of the date of issuance. The 2008 Spring Note is convertible, at the option of the noteholder, into shares of common stock of the Company (the "Conversion Shares") at a conversion price equal to the average of the closing bid price of the Company's common stock for the five trading days preceding the closing date of the 2008 Spring Offering (the "Conversion Price"). The 132,000 Conversion Shares are issuable at a Conversion Price of \$0.50 per share.

The investor in the 2008 Spring Offering received, for no additional consideration, a warrant (the "2008 Spring Warrants"), entitling the holder to purchase a number of shares of the Company's common stock equal to 50% of the number of shares of common stock into which the (2008 Spring Notes) are convertible (the "2008 Spring Warrant Shares"). The 2008 Spring Warrant Shares is exercisable on a cash basis only at a Price of \$0.50 per share, and is exercisable for a period of two years from the date of issuance. The 66,000 2008 Spring Warrant Shares are initially issuable upon exercise of the 2008 Spring Warrants.

In order to fund our capital needs for the foreseeable future, including the operations of our business, and the repayment of our outstanding Convertible Notes, we must raise substantial additional funds. In addition, we will require additional funds in connection with the license and research and development agreements with Temple University, costs associated with product development and commercialization of the ELEKTRA technology, costs to manufacture and ship our products, costs to design and implement an effective system of internal controls and disclosure controls and procedures, costs of maintaining our status as a public company by filing periodic reports with the SEC, and costs required to protect our intellectual property. We also have substantial contractual commitments, including without limitation salaries to our executive officers pursuant to employment agreements, certain severance payments to former officers and consulting fees, during the remainder of 2008 and beyond.

In light of the Company's financial commitments over the next several months and its liquidity constraints, have implemented cost reduction measures in all areas of operations, including but not limited to personnel lay-offs and/or reductions in work, reductions in marketing and advertising, deferral of placing orders to manufacturers of our ECO ChargR and MAG ChargR products for sale to our existing distributors, reductions in research and development and product development of ELEKTRA products, and reductions of certain other expenses. We intend to review these measures on an ongoing basis and make additional decisions as may be required

We may continue to use our equity arrangement for some of our additional requirements for 2008. However, the equity arrangement will not be sufficient to meet all of our current liabilities and other obligations in 2008. Among other things, the thin trading of our common stock may limit our ability to use the equity arrangement without adversely affecting the price of our common stock. Therefore, in addition to the recently-completed 2007 Winter Offering, the Company is actively pursuing additional financing alternatives, but no commitments have been received and, accordingly, no assurance can be given that any financing will be available or, if available, that it will be on terms that are satisfactory to the Company. At present, we have relatively few financing options available to us.

Contractual Obligations

The following table discloses our contractual commitments for future periods. Long-term commitments are comprised operating leases and minimum guaranteed compensation payments under employment and other agreements. See Note 12 to Notes to Condensed consolidated Financial Statements.

<u>Year ending December 31,</u>	<u>Operating Leases(1)</u>	<u>Guaranteed Payments</u>
2008	\$ 47,880	\$ 128,183(2)
2009	\$ 43,840	\$ 200,000(3)
2010	\$ 0	\$ 125,000(4)
	<u>\$ 91,720</u>	<u>\$ 453,183</u>

(1) Consists of rent for our Morgan Hill Facility expiring on August 31, 2009 and Los Angeles office expiring November 30, 2008. (For description of this property, see Part 1, Item 2, "Property").

(2) Consists of an aggregate \$20,683 in total compensation, including base salary and certain contractually-provided benefits, to one executive officer, pursuant to employment agreement that expire on July 25, 2008; \$107,500 in licensing and maintenance fees to Temple University.

(3) Consists of license and maintenance fees due to Temple University;

(4) Consists of maintenance fees due to Temple University.

License agreements with Temple University

We have entered into two license agreements with Temple University, one covering Temple University's current patent application concerning certain electric field effects on gasoline, kerosene and diesel fuel particle size distribution, and the other covering Temple University's current patent application concerning electric field effects on crude oil and edible oil viscosity, and any and all United States and foreign patents issuing in respect of the technologies described in such applications (individually, a "License Agreement" and collectively, the "License Agreements"). Initially, the License Agreements are exclusive and the territory licensed to the Company is worldwide. Pursuant to the License Agreements, the Company will pay to Temple University (i) license fees in the aggregate amount of \$250,000, payable in three installments of \$100,000, the first installment of which was paid in March 2007, and \$75,000 on each of February 2, 2008, which has not been paid, and February 2, 2009, respectively; and (ii) annual maintenance fees of \$125,000 annually commencing January 1, 2008, which has not been paid. In addition, each License Agreement separately provides that the Company will pay royalties to Temple University on net sales of products incorporating the technology licensed under that License Agreement in an amount equal to 7% of the first \$20 million of net sales, 6% of the next \$20 million of net sales and 5% of net sales in excess of \$40 million. Sales under the two License Agreements are not aggregated for purposes of calculating the royalties payable to Temple University. In addition, the Company has agreed to bear all costs of obtaining and maintaining patents in any jurisdiction where the Company directs Temple University to pursue a patent for either of the licensed technologies. Should the Company not wish to pursue a patent in a particular jurisdiction, that jurisdiction would not be included in the territory licensed to the Company.

The Company is in default in connection with its payment obligations under the License Agreements. Nonetheless, the Company has not received any written notice from Temple University of a material breach relating to required payments under the License Agreements. Any such notice must provide the Company with 60 days' notice to cure the material breach. Should the Company receive such notice, the Company's failure to cure could result in a termination of the License Agreements. Under the License Agreements the Company must pay a penalty equal to 1% per month of the amounts due and unpaid under the License Agreements.

Research and development agreement with Temple University

We have also entered into a research and development agreement ("R&D Agreement") with Temple University to conduct further research on the ELEKTRA technology. Under the R&D Agreement Temple University will conduct a 24-month research project towards expanding the scope of, and developing products utilizing, the technologies covered under the License Agreements, including design and manufacture of prototypes utilizing electric fields to improve diesel, gasoline and kerosene fuel injection in engines using such fuels and a device utilizing a magnetic field to reduce crude oil viscosity for crude oil (paraffin and mixed base) and edible oil flow in pipelines. Pursuant to the R&D Agreement, we will make payments to Temple University in the aggregate amount of \$500,000, payable in eight non-refundable installments commencing with \$123,750, which was paid in March 2007, and seven payments of \$53,750 every three months thereafter until paid in full. The payments of \$53,750 due in June, September, December 2007, March and June 2008 have not been paid. The Company is in default under the R&D Agreement, however, the Company has not received any notice of default from Temple University. If the research project yields results within the scope of the technologies licensed pursuant to the License Agreements, those results will be deemed included as rights licensed to the Company pursuant to the License Agreements. If the research project yields results outside of the scope of the technologies covered by the License Agreements, the Company has a six-month right of first negotiation to enter into a new worldwide, exclusive license agreement with Temple University for the intellectual property covered by those results.

Critical Accounting Policies and Estimates

Our discussion and analysis of our condensed consolidated financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these condensed consolidated financial statements and related disclosures requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, expenses, and related disclosure of contingent assets and liabilities. We evaluate, on an on-going basis, our estimates and judgments, including those related to the useful life of the assets. We base our estimates on historical experience and assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The methods, estimates and judgments we use in applying our most critical accounting policies have a significant impact on the condensed consolidated results that we report in our financial statements. The SEC considers an entity's most critical accounting policies to be those policies that are both most important to the portrayal of a company's financial condition and results of operations and those that require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about matters that are inherently uncertain at the time of estimation. For a more detailed discussion of the accounting policies of the Company, see Note 3 of Notes to the condensed consolidated financial statements.

We believe the following critical accounting policies, among others, require significant judgments and estimates used in the preparation of our condensed consolidated financial statements:

The preparation of financial statements in conformity with generally accepted accounting principles 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 date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Certain significant estimates were made in connection with preparing our condensed consolidated financial statements as described in Note 1 to Notes to condensed consolidated financial statements. Actual results could differ from those estimates

Revenue Recognition

The Company has adopted Staff Accounting Bulletin 104, "Revenue Recognition" and therefore recognizes revenue based upon meeting four criteria:

- Persuasive evidence of an arrangement exists;
- Delivery has occurred or services rendered;
- The seller's price to the buyer is fixed or determinable; and
- Collectability is reasonably assured.

The Company contract manufactures fixed magnetic field products and sells them to various original equipment manufacturers in the motor vehicle and small utility motor markets. The Company negotiates an initial contract with the customer fixing the terms of the sale and then receives a letter of credit or full payment in advance of shipment. Upon shipment, the Company recognizes the revenue associated with the sale of the products to the customer.

Long-lived assets

The Company accounts for the impairment and disposition of long-lived assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." In accordance with SFAS No. 144, long-lived assets to be held are reviewed for events or changes in circumstances that indicate that their carrying value may not be recoverable. The Company periodically reviews the carrying values of long-lived assets to determine whether or not impairment to such value has occurred. No impairments were recorded for the three months ended March 31, 2008. The Company recorded an impairment of approximately \$505,000 during the period from inception (February 18, 1998) through March 31, 2008.

Stock-Based Compensation

The Company periodically issues stock options and warrants to employees and non-employees in capital raising transactions, for services and for financing costs. The Company adopted SFAS No. 123R effective January 1, 2006, and is using the modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123R for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123R for all awards granted to employees prior to the effective date of SFAS No. 123R that remain unvested on the effective date. The Company accounts for stock option and warrant grants issued and vesting to non-employees in accordance with EITF No. 96-18: "Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services" and EITF No. 00-18 "Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees" whereas the value of the stock compensation is based upon the measurement date as determined at either a) the date at which a performance commitment is reached, or b) at the date at which the necessary performance to earn the equity instruments is complete.

Recent Accounting Pronouncements

In December 2007, the FASB issued FASB Statement No. 141 (R), "Business Combinations" (FAS 141(R)), which establishes accounting principles and disclosure requirements for all transactions in which a company obtains control over another business. Statement 141 (R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is prohibited.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51". SFAS No. 160 establishes accounting and reporting standards that require that the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated statement of financial position within equity, but separate from the parent's equity; the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income; and changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently. SFAS No. 160 also requires that any retained noncontrolling equity investment in the former subsidiary be initially measured at fair value when a subsidiary is deconsolidated. SFAS No. 160 also sets forth the disclosure requirements to identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, but will affect only those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. SFAS No. 160 must be applied prospectively as of the beginning of the fiscal year in which it is initially applied, except for the presentation and disclosure requirements. The presentation and disclosure requirements are applied retrospectively for all periods presented.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133," (SFAS No.161). SFAS No.161 requires enhanced disclosures about an entity's derivative and hedging activities, including (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedged items are accounted for under SFAS No. 133, and (iii) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This standard becomes effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Earlier adoption of SFAS 161 and, separately, comparative disclosures for earlier periods at initial adoption are encouraged. As SFAS No.161 only requires enhanced disclosures, this standard will have no impact on the Financial Statements

The Company does not believe that the adoption of the above recent pronouncements will have a material effect on the Company's consolidated results of operations, financial position, or cash flows.

Item 3. Quantitative and Qualitative Disclosure about Market Risk

The Company is a smaller reporting company and is not required to provide the information required by this.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-KSB. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(b) under the Securities Exchange Act of 1934 (the "Exchange Act") are not adequate to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

Management's Annual Report on Internal Control over Financial Reporting.

Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transaction and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitation, internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as required in Rule 13a-15(b). In December 2006 our Controller retired and in January 2007 our Chief Financial Officer retired, although our former Controller still provides certain financial consulting services for us. We have hired an Interim Chief Financial Officer and a full-time Controller. We have retained a consulting firm and are conducting an evaluation to design and implement adequate systems of accounting and financial statement disclosure controls. We expect to complete this review during 2008 to comply with the requirements of the SEC. We believe that the ultimate success of our plan to improve our internal control over financial reporting will require a combination of additional financial resources, outside consulting services, legal advice, additional personnel, further reallocation of responsibility among various persons, and substantial additional training of those of our officers, personnel and others, including certain of our directors such as our Chairman of the Board and committee chairs, who are charged with implementing and/or carrying out our plan. It should also be noted that the design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

Our annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting and management's report was not subject to attestation by our registered public accounting firm pursuant to temporary rules of the SEC that permit us to provide only Management's report in this annual report.

Other than as described above, there were no changes in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II

Item 1. Legal Proceedings

In April 2005, Jeffrey A. Muller, the Company's former sole director and executive officer, filed a complaint against us in the Federal District Court for the Central District of California, seeking declaratory and injunctive relief and alleging unfair competition in connection with a claimed prior patent interest in the ZEFS device and stock option rights. In seeking declaratory relief, Mr. Muller is seeking to have the patent rights in the ZEFS device that were previously transferred to us by Mr. Muller's bankruptcy trustee declared null and void.

This lawsuit brought by Mr. Muller arose out of the same claims that were the subject of litigation in the Federal District Court for the Southern District of New York, in which the Court entered judgment against Mr. Muller. Those claims are pending further proceedings. While we believe that we have valid claims and defenses, there can be no assurance that an adverse result or outcome on the pending motions or a trial of this case would not have a material adverse effect on our financial position or cash flow.

Litigation Involving Scottish Glen Golf Company

We are involved in litigation with Scottish Glen Golf Company, Inc. (SGGC) doing business as KZ Golf, Inc., the Company's previous landlord on claims in the aggregate amount of \$104,413. STWA does not dispute the fact that certain amounts of unpaid past rent are due but does dispute that it owes the aggregate of \$104,413 demanded by SGGC; more than half of which are purported "late fees" which was assessed at the rate of \$100 per day. It is the company's position that the late fees are void and unenforceable and that STWA is entitled to a set-off for office space that reverted back to SGGC.

While the Company believes that it has valid claims and defenses, given the inherent uncertainties of litigation, the Company cannot predict the outcome of this matter. Accordingly, there can be no assurance that an adverse result or outcome of this matter would not have a material adverse effect on the Company's financial position or cash flow. The Company believes that these claims arose from acts of a related party involving a former officer and director and his wife as a beneficial owners of SGGC.

Effective April 30, 2008 the Company and Scottish Glen Golf Company, Inc., dba KZG settled their pending litigation relating to the Company's prior offices. In the interest of avoiding further litigation costs and expenses, the Company and SGGC executed a "Settlement and Mutual Release Agreement effective April 30, 2008. The Company will pay SGGC the sum of \$75,000, execution of which is hereby stayed pending the following terms:

- a. Company shall pay to SGGC the sum of \$51,000 in two installments, without interest, as follows:
 - (1) \$34,000 due on or before June 2, 2008 and
 - (2) \$17,000 due on or before July 17, 2008
- b. The above payments shall be payable to SCOTTICH GLEN GOLF COMPANY, INC. dba KZG and wired transferred to the latter.
- c. In the event any payment listed above is not paid when due, then the total sum of \$75,000 shall immediately be due and owing, less any payments actually made pursuant to the Agreement and SGGC shall be entitled to file the Stipulated Judgment
- d. The Settlement and Mutual Release Agreement also provides for mutual general releases.

Upon full and complete execution of all duties and obligations by Company under the terms of this Agreement, and provided Paragraph c. above has not occurred, SGGC shall cause the Complaint to be dismissed, with prejudice, as to all causes of action and as to all parties. The Company has recorded the accrued liability at June 30, 2008. (See "Item 5-Other Information.")

Item 1A. Risk Factors

There have been no material changes in the risk factors previously disclosed in Form 10-KSB we filed with the SEC on March 31, 2008.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Morale Orchards Transaction

On December 5, 2006, we entered into a Note Purchase Agreement (the "Note Purchase Agreement") with Morale Orchards, LLC ("Morale"). The Note Purchase Agreement provides that Morale will purchase the Company's one-year Convertible Promissory Notes in the aggregate face amount of \$1,225,000 (the "Morale Notes"), and five-year Warrants (the "Morale Warrants") to purchase shares of our Common Stock at prices ranging from \$0.70 to \$0.85 per share. The aggregate purchase price for the Morale Notes and Morale Warrants is \$1,000,000. Therefore, while the stated interest on the Morale Notes is 0%, the actual interest rate is 22.5% because the Morale Notes are being purchased at a discount from their face amount.

Pursuant to the terms of the Note Purchase Agreement, Morale purchased one Morale Note in the principal amount of \$612,500 on December 5, 2006, for which it paid \$500,000 and purchased the other Morale Note in the principal amount of \$612,500 on January 10, 2007, for which it paid \$500,000. The December 5, 2006 Note is convertible into 720,588 shares of our common stock and 360,294 Warrants to purchase our common stock were issued. The January 10, 2007 Note is convertible into 875,000 shares of our common stock and 437,500 Warrants to purchase our common stock were issued. (See "Details of Recent Financing Transactions").

On January 31, 2008, a Modification and Satisfaction Agreement was entered into between the Company, Morale Orchards, LLP and Matthews & Partners. (See "Details of Recent Financing Transactions").

2007 PIPE Offering.

From January 13 through April 27, 2007, the Company conducted an offering (the "2007 PIPE Offering"), through Spencer Clarke, as exclusive placement agent. The Company raised \$400,000 gross proceeds and \$352,000 net proceeds. Interest on the 2007 PIPE Notes, at a rate of 10% per annum, is payable quarterly. The Notes are due nine months from date of issuance. The Notes are convertible into 571,429 shares of the Company's Common Stock and investors received warrants entitling the holders to purchase up to 857,144 shares of the Company's Common Stock.

The terms of the 2007 PIPE Offering were modified on August 29, 2007 and again on December 17, 2007. See ("Details of Recent Financing Transactions")

2007 Spring Offering.

From June 13, 2007 through June 26, 2007, the Company conducted a private offering (the "2007 Spring Offering") and issued Convertible Notes in the aggregate face amount of \$451,000. These notes were sold for an aggregate purchase price of \$410,000. The Notes are convertible into 1,210,489 shares of the Company's common stock and in addition, investors received warrants entitling the holders to purchase up to 605,242 shares of the Company's common stock. (See "Details of Recent Financial Transactions")

2007 Summer Offering.

From August 8, 2007 through September 27, 2007, the Company conducted a private offering (the "2007 Summer Offering") and issued Convertible Notes in the aggregate face amount \$309,980. These Notes were sold for an aggregate purchase price of \$281,800. The Notes are convertible into 837,784 shares of Company's common stock and in addition, investors received warrants entitling the holders to purchase up to 418,892 shares of the Company's common stock. (See "Details of Recent Financial Transactions").

2007 Fall Offering.

From November 14, 2007 through December 17, 2007 the Company conducted a private offering (the "2007 Fall Offering") and issued Convertible Notes in the aggregate face amount of \$622,600. These Notes were sold for an aggregate purchase price of \$566,000. The Notes are convertible into 1,596,410 shares of the Company's common stock and in addition, investors received warrants entitling the holders to purchase up to 798,205 shares of the Company's common stock. (See "Details of Recent Financing Transactions").

2007-2008 Winter Offering

From December 27, 2008 through February 29, 2008, the Company conducted a private offering (the "2008 Winter Offering") and issued Convertible Notes in the aggregate face amount of \$521,400. These Notes were sold for an aggregate purchase price of \$474,000 net proceeds. The Notes are convertible into 1,042,800 shares of the Company's common stock and in addition, investors received warrants entitling the holders to purchase up to 521,400 shares of the Company's common stock. (See "Details of Recent Financing Transactions").

The sales of the securities described above were made in reliance on the exemptions from registration set forth in Section 4(2) of the Securities Act of 1933, as amended (the "Act"), or Regulations D or S promulgated thereunder.

2008 Spring Offering

On May 27, 2008 the Company conducted a private offering (the "2008 Spring Offering") and issued a Convertible Note in the aggregate face amount of \$66,000. This note was sold for an aggregate purchase price of \$60,000 net proceeds. The Note is convertible in to 132,000 shares of the Company's common stock and in addition, the investor received warrants entitling the holder to purchase up to 66,000 shares of the Company's common stock. (See "Details of Recent Financing Transactions").

Other Issuances.

In September 2006, the Company entered into what is sometimes termed an equity arrangement with an investment banking firm. Under the arrangement the Company may sell (put) shares of common stock from time to time over a 36-month period, at a purchase price calculated at 97% of the lowest best closing bid for the Company's common stock for the five trading days following the put notice for cash. The Company may draw up to \$10,000,000. Because the price of the common stock fluctuates, the number of shares of common stock that the Company may issue when the Company exercises the put rights will vary, the Company does not know how many shares will actually be issued under the put. On October 6, 2006, the Company filed a Registration Statement which was effective October 30, 2006 which registered and made

available 7,000,000 shares of common stock for possible future draws under the line of credit.

During the year ended December 31, 2007 the Company drew down \$ 992,055 (\$912,683 net of closing costs) and issued 1,880,421 shares of common stock. As of June 30, 2008 the Company has drawn down \$1,372,150 (\$1,262,378) net of closing costs) of this commitment and issued 2,367,905 shares at an average price of \$0.58 per share, leaving 4,632,095 shares available under the equity line of credit.

In August 2007, the Company issued 2,597,524 shares in connection with the exercise of options that were originally granted to the late Edward L. Masry.

During the year ended December 31, 2007, the Company issued 1,910,711 shares of common stock in exchange for conversion of \$526,480 of Convertible Notes

During the six months ended June 30, 2008, the Company issued 7,421,896 shares of common stock in exchange for \$1,855,474 conversion of Convertible Notes and settlement of loan and payable in accordance with the Morale Orchards-Matthews Modification Agreement. The Company incurred and recorded additional non-cash interest and legal expense in the amount of \$928,237.

During the six months ended June 30, 2008, the Company issued 2,620,860 shares of common stock in exchange for conversion of \$1,067,000 of other Convertible Notes.

During the six months ended June 30, 2008, the Company issued 17,838 shares of common stock in exchange for consulting services in the amount of \$6,900.

During the six months ended June 30, 2008, the Company issued 156,012 shares of common stock for settlement of \$48,979 in payables.

During the six months ended June 30, 2008, the Company issued 661,660 shares of common stock for exercise of warrants for which the Company received \$330,830.

Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

None

Item 6. Exhibits

<u>Exhibit No.</u>	<u>Description</u>
31.1	Certification of Chief Executive Officer of Quarterly Report Pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e)
31.2	Certification of Chief Financial Officer of Quarterly Report Pursuant to 18 U.S.C. Section 1350
32	Certification of Chief Executive Officer and Chief Financial Officer of Quarterly Report pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e)

SIGNATURES

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

SAVE THE WORLD AIR, INC.

Date: August 13, 2008

By: /s/ EUGENE E. EICHLER

Eugene E. Eichler
Interim Chief Financial Officer

EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Description</u>
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**CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002
AND RULES 13A-14 AND 15D-14 UNDER THE SECURITIES EXCHANGE ACT OF 1934**

I, Charles R. Blum, certify that:

1. I have reviewed this Quarterly Report on Form 10-QSB of Save the World Air, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its condensed consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 13, 2008

/s/ CHARLES R. BLUM

Charles R. Blum
Chief Executive Officer

**CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002
AND RULES 13A-14 AND 15D-14 UNDER THE SECURITIES EXCHANGE ACT OF 1934**

I, Eugene E. Eichler, certify that:

1. I have reviewed this Quarterly Report on Form 10-QSB of Save the World Air, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its condensed consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 13, 2008

/s/ EUGENE E. EICHLER

Eugene E. Eichler
Interim Chief Financial Officer

**CERTIFICATION OF PERIODIC FINANCIAL REPORT BY THE CHIEF EXECUTIVE
OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Solely for the purposes of complying with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, we, the undersigned Acting Chief Executive Officer and the Chief Financial Officer of Save the World Air, Inc. (the "Company"), hereby certify, based on our knowledge, that the Quarterly Report on Form 10-QSB of the Company for the quarter ended March 31, 2007 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 13, 2008

/s/ CHARLES R. BLUM

Charles R. Blum
Chief Executive Officer

Date: August 13, 2008

/s/ EUGENE E. EICHLER

Eugene E. Eichler
Interim Chief Financial Officer

