

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended September 30, 2004.

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.)

5125 Lankershim Boulevard

North Hollywood, California 91601

(Address, including zip code, of principal executive offices)

(818) 487-8000

(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

The number of shares of the Registrant's Common Stock outstanding as of September 30, 2004 was 37,015,821 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Transitional Small Business Disclosure Format (Check one): Yes No

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PART I

Item 1. Financial Statements

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

NINE MONTHS ENDED SEPTEMBER 30, 2004

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

BALANCE SHEETS
SEPTEMBER 30, 2004 (UNAUDITED) AND DECEMBER 31, 2003

	<u>Sept. 30, 2004</u> <u>(unaudited)</u>	<u>December 31,</u> <u>2003</u>
ASSETS		
Current assets		
Cash	\$ 223,102	\$ 926,052
Prepaid expenses	50,000	—
Total current assets	<u>273,102</u>	<u>926,052</u>
Property and equipment , net of accumulated depreciation	39,839	35,244
	<u>\$ 312,941</u>	<u>\$ 961,296</u>

See notes to condensed financial statements.

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(A DEVELOPMENT STAGE ENTERPRISE)**BALANCE SHEETS — Continued**
SEPTEMBER 30, 2004 (UNAUDITED) AND DECEMBER 31, 2003

	Sept. 30, 2004 (unaudited)	December 31, 2003
LIABILITIES AND STOCKHOLDERS' DEFICIENCY		
Current liabilities		
Income taxes payable	\$ —	\$ 5,991
Payables to related parties	36,478	57,903
Accrued professional fees	787,463	551,582
Finders fees payable	35,063	128,916
Other accrued liabilities	—	33,082
Total current liabilities	<u>859,004</u>	<u>777,474</u>
Due to founding executive officer	<u>1,017,208</u>	<u>1,017,208</u>
Commitments and contingencies		
Stockholders' deficiency		
Common stock, \$.001 par value: 200,000,000 shares authorized, 37,015,821 and 34,128,261 shares issued and outstanding at September 30, 2004 and December 31, 2003, respectively	37,015	34,128
Common stock to be issued	235,000	6,250
Additional paid-in capital	13,270,211	10,162,177
Deferred compensation	(175,760)	(708,333)
Deficit accumulated during the development stage	(14,929,737)	(10,327,608)
Total stockholders' deficiency	<u>(1,563,271)</u>	<u>(833,386)</u>
	<u>\$ 312,941</u>	<u>\$ 961,296</u>

See notes to condensed financial statements.

[Table of Contents](#)**SAVE THE WORLD AIR, INC.**
(A DEVELOPMENT STAGE ENTERPRISE)**STATEMENTS OF OPERATIONS (UNAUDITED)**
THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2004 and 2003 AND FOR THE PERIOD FROM INCEPTION
(FEBRUARY 18, 1998) TO SEPTEMBER 30, 2004

	Three months ended September 30,		Nine months ended September 30,		Cumulative since inception
	2004	2003	2004	2003	
Net sales	\$ —	\$ —	\$ —	\$ —	\$ —
Operating expenses	918,310	385,127	2,574,713	1,207,137	12,117,052
Research and development expenses	162,458	141,778	445,727	365,417	1,225,489
Non-cash settlement cost	1,585,266	—	1,585,266	—	1,585,266
Loss before other income	(2,666,034)	(526,905)	(4,605,706)	(1,572,554)	(14,927,807)
Other income					
Interest income	—	—	514	—	954
Loss before provision for income taxes	(2,666,034)	(526,905)	(4,605,192)	(1,572,554)	(14,926,853)
Provision (benefit) for income taxes	(4,063)	—	(3,063)	1,020	2,884
Net loss	<u>\$ (2,661,971)</u>	<u>\$ (526,905)</u>	<u>\$ (4,602,129)</u>	<u>\$ (1,573,574)</u>	<u>\$ (14,929,737)</u>
Net loss per share, basic and diluted	<u>\$ (0.07)</u>	<u>\$ (0.02)</u>	<u>\$ (0.13)</u>	<u>\$ (0.06)</u>	
Weighted average shares outstanding, basic and diluted	<u>36,599,887</u>	<u>28,400,734</u>	<u>35,328,591</u>	<u>24,683,423</u>	

See notes to condensed financial statements.

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

STATEMENTS OF STOCKHOLDERS' DEFICIENCY
FROM INCEPTION (FEBRUARY 18, 1998) TO SEPTEMBER 30, 2004

	Price per share	Common Stock		Common stock to be issued	Additional paid-in capital	Deferred compensation	Deficit accumulated during the development stage	Total stockholders' development stage deficiency
		Shares	Amount					
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 (as corrected, see Note 1)		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 (as corrected, see Note 1)		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
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
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

See notes to condensed financial statements.

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

STATEMENTS OF STOCKHOLDERS' DEFICIENCY — Continued
FROM INCEPTION (FEBRUARY 18, 1998) TO SEPTEMBER 30, 2004

	Price per share	Common Stock		Common stock to be issued	Additional paid-in capital	Deferred compensation	Deficit accumulated during the development stage	Total stockholders' development stage deficiency
		Shares	Amount					
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 (as corrected, see Note 1)		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
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
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 services on November 2, 2001	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
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)

See notes to condensed financial statements.

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

STATEMENTS OF STOCKHOLDERS' DEFICIENCY — Continued
FROM INCEPTION (FEBRUARY 18, 1998) TO SEPTEMBER 30, 2004

	Price per share	Common Stock		Common stock to be issued	Additional paid-in capital	Deferred compensation	Deficit accumulated during the development stage	Total stockholders' development stage deficiency
		Shares	Amount					
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		—	—	—	—	—	(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
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' fees 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)
Common stock issued, previously paid for	0.25	25,000	25	(6,250)	6,225	—	—	—
Stock issued for director services on March 31, 2004	0.25	50,000	50	—	12,450	—	—	12,500
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

See notes to condensed financial statements.

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

STATEMENTS OF STOCKHOLDERS' DEFICIENCY — Continued
FROM INCEPTION (FEBRUARY 18, 1998) TO SEPTEMBER 30, 2004

	Price per share	Common Stock		Common stock to be issued	Additional paid-in capital	Deferred compensation	Deficit accumulated during the development stage	Total stockholders' development stage deficiency
		Shares	Amount					
Stock issued for services on April 2, 2004	0.25	65,000	65	—	16,185	—	—	16,250
Debt converted to stock on April 2, 2004	0.25	60,000	60	—	14,940	—	—	15,000
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	0.25	600,000	600	—	149,400	—	—	150,000
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
Stock issued for consulting services on September 22, 2004	1.24	20,000	20	—	24,780	—	—	24,800
Finders fees related to stock issuances		—	—	—	(64,928)	—	—	(64,928)
Common stock paid for, but not issued (235,000 shares)		—	—	235,000	—	—	—	235,000
Intrinsic value of options issued to employees		—	—	—	359,582	(359,582)	—	—
Fair value of options issued to non-employees for services		—	—	—	60,120	(60,120)	—	—
Fair value of warrants issued for settlement costs		—	—	—	1,585,266	—	—	1,585,266
Amortization of deferred comp		—	—	—	—	952,275	—	952,275
Net loss for nine months ended September 30, 2004		—	—	—	—	—	(4,602,129)	(4,602,129)
Balance, September 30, 2004 (unaudited)		<u>37,015,821</u>	<u>\$37,015</u>	<u>\$ 235,000</u>	<u>\$13,270,211</u>	<u>\$ (175,760)</u>	<u>\$ (14,929,737)</u>	<u>\$ (1,563,271)</u>

See notes to condensed financial statements.

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(A DEVELOPMENT STAGE ENTERPRISE)**STATEMENTS OF CASH FLOWS (UNAUDITED)**
NINE MONTHS ENDED SEPTEMBER 30, 2004 AND
2003 AND FOR THE PERIOD FROM INCEPTION (FEBRUARY 18, 1998) TO SEPTEMBER 30, 2004

	Sept. 30, 2004	Sept. 30, 2003	Cumulative since inception
Cash flows from operating activities			
Net loss	\$(4,602,129)	\$(1,573,574)	\$(14,929,737)
Adjustments to reconcile net loss to net cash used in operating activities:			
Write off of intangible assets		—	505,000
Fair value of options issued for services		—	142,318
Issuance of common stock for services	269,050	45,877	4,146,923
Amortization of deferred compensation	952,275	651,226	2,898,850
Depreciation	6,323	3,724	12,055
Non-cash settlement cost	1,585,266	—	1,585,266
Changes in operating assets and liabilities:			
Prepaid expenses	(50,000)	—	(50,000)
Income taxes payable	(5,991)	1,064	—
Accrued expenses	157,999	(131,230)	558,998
Net cash used in operating activities	<u>(1,687,207)</u>	<u>(1,002,913)</u>	<u>(5,130,327)</u>
Cash flows from investing activities			
Purchase of property and equipment	<u>(10,918)</u>	<u>(1,672)</u>	<u>(48,344)</u>
Net cash used in investing activities	<u>(10,918)</u>	<u>(1,672)</u>	<u>(48,344)</u>
Cash flows from financing activities			
Increase (decrease) in payables to related parties	(6,425)	(21,146)	547,928
Advances from founding executive officer	—	—	517,208
Issuance of common stock for cash	766,600	1,441,068	4,101,637
Common stock issuable	235,000	187,500	235,000
Net cash provided by financing activities	<u>995,175</u>	<u>1,607,422</u>	<u>5,401,773</u>
Net increase (decrease) in cash	<u>(702,950)</u>	<u>602,837</u>	<u>223,102</u>
Cash, beginning of period	<u>926,052</u>	<u>107,489</u>	<u>—</u>
Cash, end of period	<u>\$ 223,102</u>	<u>\$ 710,326</u>	<u>\$ 223,102</u>

See notes to condensed financial statements.

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

STATEMENTS OF CASH FLOWS — Continued (UNAUDITED)
NINE MONTHS ENDED SEPTEMBER 30, 2004 and 2003 AND FOR THE PERIOD FROM INCEPTION (FEBRUARY 18, 1998) TO SEPTEMBER 30, 2004

	Sept. 30, 2004	Sept. 30, 2003	Cumulative since inception
Supplemental disclosures of cash flow information			
Income taxes	\$ 2,400	\$ —	\$ 2,400
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	419,702	—	3,074,611
Purchase of property and equipment financed by advance from related party	—	—	3,550
Conversion of related party debt to equity	15,000	500,000	515,000
Issuance of common stock in settlement of payable	113,981	—	113,981
Common stock, previously paid for	6,250	—	—
Fees accrued for issuance of common stock	64,928	153,509	377,510

See notes to condensed financial statements.

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

**NOTES TO FINANCIAL STATEMENTS
NINE MONTHS ENDED SEPTEMBER 30, 2004 (UNAUDITED)**

1. Organization and basis of presentation

Basis of presentation

The accompanying interim condensed financial statements are unaudited, but in the opinion of management of Save the World Air, Inc. (the Company), contain all adjustments, which include normal recurring adjustments, necessary to present fairly the financial position at September 30, 2004, the results of operations for the three and nine months ended September 30, 2004 and 2003, and cash flows for the nine months ended September 30, 2004 and 2003. The balance sheet as of December 31, 2003 is derived from the Company's audited financial statements.

Certain information and footnote disclosures normally included in financial statements that have been prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission, although management of the Company believes that the disclosures contained in these financial statements are adequate to make the information presented therein not misleading. For further information, refer to the financial statements and the notes thereto included in the Company's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2003, as filed with the Securities and Exchange Commission.

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, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expense during the reporting period. Actual results could differ from those estimates.

The results of operations for the nine months ended September 30, 2004 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2004.

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

**NOTES TO FINANCIAL STATEMENTS — Continued
NINE MONTHS ENDED SEPTEMBER 30, 2004 (UNAUDITED)**

1. Organization and basis of presentation - Continued

Description of business

Save the World Air, Inc. (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 signing of an agreement by and between the Company and Jeffrey Alan Muller, the Company’s founding executive officer and director, with respect to the Company’s purchase of the Zero Emission Fuel-Saving Device (the “Agreement”). Under the terms of the Agreement, the Company issued 5,000,000 shares of its common stock to Mr. Muller and agreed to pay him a total of \$500,000 for the marketing and distribution rights of the device, and a \$10 royalty for every unit of the device sold (see additional discussion in the Significant Matters section of this note). The Company acquired the worldwide exclusive manufacturing, marketing and distribution rights for the Zero Emission Fuel-Saving Device (“ZEFS”) by entering into the Agreement. The ZEFS is a product, which is fitted to an internal combustion engine and is expected to reduce carbon monoxide hydrocarbons and toxic exhaust emissions. The ZEFS is currently undergoing testing to determine the achievable levels of reduced emissions and commercial viability.

Significant matters

On December 19, 2001, the SEC filed civil charges in the United States Federal District Court, Southern District of New York, against us, our former President and then sole board director Jeffrey A. Muller, and others, alleging that we and the other defendants were engaged in a fraudulent scheme to promote our stock. The SEC complaint alleged the existence of a promotional campaign using press releases, Internet postings, an elaborate website, and televised media events to disseminate false and materially misleading information as part of a fraudulent scheme to manipulate the market for stock in our corporation, which was then controlled by Mr. Muller. On March 22, 2002, we signed a Consent to Final Judgment of Permanent Injunction and Other Relief in settlement of this action as against the corporation only, which the court approved on July 2, 2002. Under this settlement, we were not required to admit fault and did not pay any fines or restitution. The SEC’s charges of fraud and stock manipulation continues against Mr. Muller and others.

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

NOTES TO FINANCIAL STATEMENTS — Continued
NINE MONTHS ENDED SEPTEMBER 30, 2004 (UNAUDITED)

1. Organization and basis of presentation - Continued

Significant matters — Continued

On July 2, 2002, after an investigation by our newly constituted board of directors, we filed a cross-complaint in the SEC action against Mr. Muller and others seeking injunctive relief, disgorgement of monies and stock and financial restitution for a variety of acts and omissions in connection with sales of our stock and other transactions occurring between 1998 and 2002. Among other things, we alleged that Mr. Muller and certain others sold company stock without providing adequate consideration to SWA; sold insider shares without making proper disclosures and failed to make necessary filings required under federal securities laws; engaged in self-dealing and entered into various undisclosed related-party transactions; misappropriated for their own use proceeds from sales of our stock; and entered into various undisclosed arrangements regarding the control, voting and disposition of their stock. We contend that we are entitled to a judgment canceling all of the approximately 8,716,710 shares of our common stock which we believe are controlled, directly or indirectly, by Mr. Muller; divesting Mr. Muller of any right to exercise options for 10,000,000 shares of our stock, conversion of an existing preliminary injunction to a permanent injunction to prevent Mr. Muller from any involvement with the company and a monetary judgment against Muller and others in the amount of several million dollars. SWA is also seeking cancellation of the previous royalty arrangement with Mr. Muller.

On July 30, 2002, the U.S. Federal District Court, Southern District of New York, granted our application for a preliminary injunction against Mr. Muller and others, which prevents Mr. Muller and other cross-defendants from selling, transferring, or encumbering any assets and property previously acquired from SWA, from selling or transferring any of our stock that they may own or control, or from taking any action to injure us or our business and from having any direct contact with our shareholders. The injunctive order also prevents Mr. Muller from engaging in any effort to exercise control over our corporation and from serving as an officer or director of our company. While we believe that we have valid claims, there can be no assurance that an adverse result or settlement would not have a material adverse effect on our financial position or cash flow.

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

**NOTES TO FINANCIAL STATEMENTS — Continued
NINE MONTHS ENDED SEPTEMBER 30, 2004 (UNAUDITED)**

1. Organization and basis of presentation - Continued

Significant matters — Continued

In the course of the litigation, we have obtained ownership control over Mr. Muller's claimed patent rights to the ZEFS device. Under a Buy-Sell Agreement between Jeffrey Muller and SWA dated December 29, 1998, Mr. Muller, who was listed on the ZEFS device patent application as the inventor of the ZEFS device, purported to grant SWA all international marketing, manufacturing and distribution rights to the ZEFS device. Those rights were disputed because an original inventor of the ZEFS device contested Muller's legal ability to have conveyed those rights. In Australia, Muller entered into a bankruptcy action seeking to overcome our claims for ownership of the ZEFS device. In conjunction with these litigation proceedings, a settlement agreement was reached whereby the \$10 per unit royalty previously due to Mr. Muller under his contested Buy-Sell Agreement was terminated and replaced with a \$.20 per unit royalty payable to the bankruptcy trustee. On November 7, 2002, under a settlement agreement executed with the Muller bankruptcy trustee, the trustee transferred all ownership and legal rights to this international patent application for the ZEFS device to us.

Both the SEC and SWA have filed Motions for Summary Judgment contending that there are no material issues of fact in contention and as a matter of law, the Court should grant a judgment against Jeffrey A. Muller and the cross-defendants. Muller has filed a response contending that the actions against him should be dismissed. A decision on these motions would potentially terminate the ongoing litigation. Further proceedings for all pretrial motions have been assigned to U.S. Magistrate Frank Maas. An initial decision will be made by Judge Maas after a hearing on the Motions which is expected to occur within the next 60 days. Should Judge Maas determine that there are material issues in dispute the case could be continued for a final disposition by a trial.

Although the outcome of this litigation cannot be predicted with any degree of certainty, we are optimistic that the Court's ruling will either significantly narrow the issues for any later trial or will result in a final disposition of the case in a manner favorable to the company. While we believe that we have valid claims, 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.

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

NOTES TO FINANCIAL STATEMENTS — Continued
NINE MONTHS ENDED SEPTEMBER 30, 2004 (UNAUDITED)

1. Organization and basis of presentation - Continued

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.

A team has been assembled for the research and development of the technology and potential markets for the ZEFS and to establish relationships with potential customers. Significant design work has been completed, and patent applications have been filed in 64 countries. There is no assurance that any of the filed patents will be granted. The Company is continuing in its product development efforts and several studies are underway to evaluate the effectiveness of the ZEFS in eliminating pollutants and emissions from internal combustion engines. The Company has had no sales to date.

As such, the Company continues to remain a development stage enterprise. The ability of the Company to commercialize its products will depend on, among other things, the Company's ability to demonstrate the merits of the ZEFS and develop markets and distribution channels.

2. Net loss per share

Basic earnings (loss) per share is computed by dividing net income 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 will 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 three and nine months ended September 30, 2004 and 2003, the dilutive impact of outstanding stock options of 15,168,652 and 14,000,000, respectively, and 14,117,414 and 10,252,414 warrants have been excluded because their impact on the loss per share is antidilutive.

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

**NOTES TO FINANCIAL STATEMENTS — Continued
NINE MONTHS ENDED SEPTEMBER 30, 2004 (UNAUDITED)**

3. New accounting pronouncements

In January 2003, the FASB issued FASB Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities," which clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," relating to consolidation of certain entities. In December 2003, the FASB issued a revised FIN 46 "46R" that replaced the original FIN 46. FIN 46R requires identification of a company's participation in variable interest entities (VIEs), which are defined as entities with a level of invested equity that is not sufficient to fund future activities to permit it to operate on a standalone basis. For entities identified as a VIE, FIN 46R sets forth a model to evaluate potential consolidation based on an assessment of which party to the VIE (if any) bears a majority of the exposure to its expected losses, or stands to gain from a majority of its expected returns. FIN 46R also sets forth certain disclosures regarding interests in VIEs that are deemed significant, even if consolidation is not required. The Company is not currently participating in, or invested in any VIEs, as defined in FIN 46R.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS No. 150 establishes accounting standards for how a company classifies and measures financial instruments that have characteristics of liabilities and equity. FASB Staff Position No. 150-3 subsequently deferred the effective date for applying the provisions of SFAS No. 150. For instruments that are mandatorily redeemable on fixed dates for amounts that are fixed or otherwise determinable, the provisions of SFAS 150 shall be effective for fiscal periods beginning after December 15, 2004. For all other instruments the provisions of SFAS 150 are deferred indefinitely.

4. Certain relationships and related transactions

Due to founding executive officer

All of the marketing and manufacturing rights for the ZEFS were acquired from Mr. Muller, for 5,000,000 shares of common stock, \$500,000 and a \$10 royalty for each unit sold (see discussion below), pursuant to the Agreement entered into in December 1998, by and between the Company and Mr. Muller. Working capital advances in the amount of \$517,208 and payment in the amount of \$500,000 for marketing and distribution rights of the ZEFS are due to Mr. Muller. Such amounts are interest free and do not have any due dates for payment.

In January 2000, the Company entered into an agreement offering Mr. Muller and Lynne Muller, Mr. Muller's wife, the option to purchase 5,000,000 shares each at \$0.10 per share as consideration for work performed for the Company. Mrs. Muller subsequently transferred her option to Mr. Muller.

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

NOTES TO FINANCIAL STATEMENTS — Continued
NINE MONTHS ENDED SEPTEMBER 30, 2004 (UNAUDITED)

4. Certain relationships and related transactions - Continued

Due to founding executive officer — Continued

In connection with the Company's legal proceedings against Mr. Muller, the Company is attempting to obtain a judgment that will relieve the Company of \$1,017,208, which has been reflected as a long-term liability in the accompanying balance sheet and represents all amounts due to Muller. These amounts include the \$500,000 due for the marketing and distribution rights of the ZEFs and the working capital advances of \$517,208. As described in the Significant Matters section of Note 1, the Company has already been relieved of the \$10 royalty interest that Mr. Muller held for each unit sold. In addition, the Company is also attempting to obtain a judgment that will cancel the options to purchase 10,000,000 shares granted to Mr. and Mrs. Muller, collectively.

Based on the status of current legal proceedings, the Company does not believe that it will have to pay Mr. Muller the \$500,000 for the rights to the ZEFs device and the \$517,208 of advances. The Company also believes that the option Mr. Muller holds to purchase 10,000,000 shares of the Company's stock will be cancelled and no longer valid.

Due to related parties

Masry & Vititoe, a law firm in which Edward Masry is a partner, has advanced \$36,478 and \$57,903 as of September 30, 2004 and December 31, 2003 to the Company for working capital purposes. The advances payable to Masry & Vititoe were allocations to the Company for shared expenses, primarily payroll. These advances are unsecured, non-interest bearing, and are due on demand. In April 2004, accounts payable due this firm totaling \$15,000 was converted to 60,000 shares of common stock.

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

NOTES TO FINANCIAL STATEMENTS — Continued
NINE MONTHS ENDED SEPTEMBER 30, 2004 (UNAUDITED)

5. Stock options and warrants

The Company issues stock options to employees, directors and consultants under no formal plan. 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 or up to one year. The weighted average remaining contractual life of employee options outstanding at September 30, 2004 was 7.32 years. Stock option activity for the year ended December 31, 2003 and nine months ended September 30, 2004, was as follows:

	Options	Weighted Avg. Exercise Price
Options outstanding, January 1, 2003	14,000,000	\$ 0.13
Options granted	—	—
Options exercised	—	—
Options cancelled	—	—
Options, December 31, 2003	14,000,000	0.13
Options granted	1,172,652	1.04
Options exercised	(4,000)	0.40
Options cancelled	—	—
Options, September 30, 2004	<u>15,168,652</u>	<u>\$ 0.20</u>

For the nine months ended September 30, 2004, 4,000 options were exercised

Options outstanding at September 30, 2004 and the related weighted average exercise price and remaining life information is as follows:

Range of exercise prices	Total options outstanding	Weighted average remaining life in years	Total weighted average exercise price	Options exercisable	Weighted average exercise price
\$ 0.10	10,000,000	N/A	\$ 0.10	10,000,000	\$ 0.10
0.10	3,000,000	5.09	0.10	2,000,000	0.10
0.40	746,000	7.05	0.40	746,000	0.40
0.50	150,000	1.95	0.50	150,000	0.50
1.00	100,000	2.50	1.00	100,000	1.00
.98	900,000	4.25	.98	—	—
1.15	193,912	4.25	1.15	—	—
1.27	78,740	4.25	1.27	—	—
<u>\$0.10 - \$1.27</u>	<u>15,168,652</u>	<u>5.04</u>	<u>\$ 0.20</u>	<u>12,996,000</u>	<u>\$ 0.25</u>

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

NOTES TO FINANCIAL STATEMENTS — Continued
NINE MONTHS ENDED SEPTEMBER 30, 2004 (UNAUDITED)

5. Stock options and warrants - Continued

The 10,000,000 options exercisable at \$0.10 per share in the table above are held by Mr. Muller. The options have been accounted for as employee stock options under the provisions of APB No. 25. Accordingly, no compensation expense has been recorded in the statements of operations. However, the \$1,000,000 fair value of the options has been reflected in the pro forma net loss below. The 10,000,000 options do not have an expiration date and vested in 1999. For purposes of computing fair value method stock-based employee compensation expense for the 10,000,000 employee options above, a ten-year life was used in the Black-Scholes option-pricing model, as ten years is the longest term for other option grants.

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

	<u>Warrants</u>	<u>Weighted Avg. Exercise Price</u>
Warrants outstanding, January 1, 2003	1,850,000	\$ 0.06
Warrants granted	11,517,414	0.46
Warrants exercised	—	—
Warrants cancelled	—	—
Warrants outstanding, December 31, 2003	13,367,414	0.52
Warrants granted	1,700,000	0.14
Warrants exercised	(950,000)	(0.01)
Warrants cancelled	—	—
Warrants outstanding, September 30, 2004	<u>14,117,414</u>	<u>\$ 0.59</u>

During the three months ended September 30, 2004, the Company issued 1,000,000 ten-year warrants to acquire 1,000,000 shares of the Company's common stock. The warrants require a payment of \$1 for each share purchased. The warrants were issued to finalize a settlement with the bankruptcy trustee and others who had claims to ZEFS technology in exchange for the full release of their claims. The Company valued the warrants at \$1,585,265 and expensed the amount as settlement costs during the three months ended September 30, 2004. The warrants were issued in July 2004 when the Company became current in its SEC filings. The warrants were valued by the Company using the Black-Scholes pricing model using a ten year term (statutory term), 46.2% volatility, no annual dividends, and a discount rate of 4.57%. The trustee and the other individuals will also receive royalties when the product is sold. There are no minimum royalties required.

Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123), establishes a fair value method of accounting for stock-based compensation plans and for transactions in which an entity acquires goods or services from non-employees in exchange for equity instruments. SFAS No. 123 also encourages, but does not require companies to record compensation cost for stock-based employee compensation. SFAS No. 123 was amended by SFAS No. 148, which now requires companies to disclose in interim financial statements the pro forma effect on net income (loss) and net income (loss) per common share of the estimated fair market value of stock options or warrants issued to employees. The Company has chosen to continue to account for stock-based compensation utilizing the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", with pro forma disclosures of net income (loss) as if the fair value method had been applied. Accordingly, compensation cost for stock options is measured as the excess, if any, of the fair market price of the Company's stock at the date of grant over the amount an employee must pay to acquire the stock.

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

NOTES TO FINANCIAL STATEMENTS — Continued
NINE MONTHS ENDED SEPTEMBER 30, 2004 (UNAUDITED)

5. Stock options and warrants - Continued

Certain employee options were granted with exercise prices less than fair market value of the Company's stock at the date of grant. As the grants were to employees, the intrinsic value method, as allowed under APB No. 25, was used to calculate the related compensation expense. For the nine months ended September 30, 2004, \$952,275 and \$45,000, respectively of employee-deferred compensation and non-employee deferred compensation, respectively was amortized and recognized as expense. The remaining deferred compensation expense will be recognized over the remaining vesting periods of the employee options through 2004.

The Company has elected to account for stock-based compensation using the intrinsic value method prescribed in APB No. 25 and related interpretations, and follow the pro forma disclosure requirements of SFAS No. 123. Accordingly, no compensation expense has been recognized related to the granting of stock options, except as noted above. The following table illustrates the effect on net income as if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation.

	<u>Sept. 30,</u> <u>2004</u>	<u>Sept. 30,</u> <u>2003</u>	<u>Cumulative</u> <u>since</u> <u>inception</u>
Net loss, as reported	\$(4,602,129)	\$(1,573,575)	\$(14,929,737)
Add: total fair value method stock-based employee compensation expense	(1,721,718)	(712,483)	(3,930,000)
Less: deferred compensation amortization for below market employee options	<u>907,185</u>	<u>637,500</u>	<u>2,798,852</u>
Pro forma net loss	<u>\$(5,416,662)</u>	<u>\$(1,648,558)</u>	<u>\$(16,060,885)</u>
Pro forma loss per share	<u>\$ (0.15)</u>	<u>\$ (0.07)</u>	

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

NOTES TO FINANCIAL STATEMENTS — Continued NINE MONTHS ENDED SEPTEMBER 30, 2004 (UNAUDITED)

6. Research and development

We have established a research and development facility in Queensland, Australia. We have purchased test vehicles, test engines and testing equipment. We have completed testing on ZEFS devices for the VW Beetle and Ford Mustangs, which has been provided to RAND for evaluation. Through September 30, 2004, we have continued research on devices for the two and four-stroke engines and thin line two and four barrel carbureted devices. We have expanded research and development to include applications of the ZEFS technology to diesel engines, motorbikes and boats. No proceeds were spent on research and development prior to 2002. We spent \$445,727 and \$365,417 for the nine months ended September 30, 2004 and 2003, respectively, and \$162,458 and \$141,778 for the three months ended September 30, 2004 and 2003, respectively, on research and development.

7. Going concern

The accompanying 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 financial statements, the Company had a net loss of \$4,602,129 and, a negative cash flow from operations of \$1,687,207 for the nine months ended September 30, 2004 and had a working capital deficiency of \$585,902 and a stockholders' deficiency of \$1,563,271 as of September 30, 2004. The ability of the Company to continue as a going concern is dependent on the Company's ability to raise additional funds and implement its business plan. The financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

The Company believes that it has sufficient cash to fund its operations through at least the end of the fourth quarter of 2004. In order to meet its operational needs, the Company is raising additional capital in a private offering. However, there can be no assurance that additional financing will be available or, if it is available, that it will be available on terms that are favorable to the Company. If the Company is unable to obtain additional capital, it may be required to delay, reduce the scope of, or eliminate its research and development programs, or relinquish rights to technologies that it might otherwise seek to develop or commercialize.

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

NOTES TO FINANCIAL STATEMENTS — Continued
NINE MONTHS ENDED SEPTEMBER 30, 2004 (UNAUDITED)

8. Subsequent events

On October 1, 2004 the Company entered into a representation agreement with an individual who will represent and introduce the Company to key personnel in India. The representative will be granted 50,000 warrants at \$1.00 upon signing of the agreement. Once all duties have been performed, the representative will receive an additional 50,000 warrants at the medium price of stock traded on March 31, 2005 at a discount of 30%, plus 2% royalty on gross receipts from contracts that are signed from his contract. The fair value of the 50,000 warrants issued upon signing is \$24,428 using the black-scholes pricing model.

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Item 2. Management's Discussion and Analysis

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

- research and development expenses;
- scientific test results;
- general and administrative expenses;
- liquidity and sufficiency of existing cash;
- technology;
- the outcome of pending or threatened litigation.

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.

Such statements, which include statements concerning future revenue sources and concentrations, selling, general and administrative expenses, research and development expenses, capital resources, additional financings and additional losses, are subject to risks and uncertainties, including, but not limited to, those discussed elsewhere in this Form 10-QSB, that could actual results to differ materially from those projected.

Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth below under the heading “Risk Factors” in our Annual Report on Form 10-KSB for the year ended December 31, 2003. 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.

The forward-looking statements set forth in this Form 10-QSB are as of September 30, 2004, and we undertake no duty to update this information.

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Overview

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the Financial Statements and notes thereto included in Part I, Item 1 of this Form 10-QSB and the Financial Statements and notes thereto contained in our Annual Report on Form 10-KSB for the fiscal year ended December 31, 2003.

We are a development stage company that has not yet commenced operations and does not generate revenue. Our current focus is on research and development of proprietary devices that can be installed on motor vehicles and which are designed to reduce harmful emissions, improve fuel efficiency and improve performance. Utilizing our test vehicles, motorcycles, engines and equipment at our research and development facilities in Australia and the United States, we have created prototype devices for one-, two- and four-barrel carbureted engines and multiple devices for fuel injection engines that we call "ZEFS". We have devoted the bulk of our efforts to complete the design and development of our production models and raise the financing required to do so and to fund our expenses.

We have also recently developed devices for use on two- and four-stroke motorcycles, generators and lawnmower engines, which we call "CAT-MATE". On June 4, 2004, we filed a New Provisional Patent Application for an "Inline Exhaust Device to Improve Efficiency of a Catalytic Converter". We have also trademarked the name "CAT-MATE".

We anticipate that our research and development efforts will continue for at least the remainder of 2004. We do not envision generating any significant revenue in 2004, although limited marketing activities later in 2004 could produce nominal revenue. We are in the process of raising additional capital to fund continuing research and development activities and meet our operating expenses, including marketing activities, for the remainder of 2004.

In July 2004, we announced that we were joined by Erin Brockovich, who assumed a position with our management team as our Vice President of Environmental Affairs. In October 2004, we retained Dr. Gurminder Singh to act as our representative in India to develop ties between our company and leading members of the Indian government, business community and academia.

Results of Operations

To date, we have not generated any revenues and our business is in the development stage.

Our operating costs and expenses consist primarily of general and administrative expenses. We expect our operating costs to increase once we begin to manufacture and market the ZEFS and CAT-MATE devices, which we do not expect to occur earlier than the fourth quarter of 2004.

Our general and administrative expenses include compensation expenses related to executive and other administrative personnel, facility lease, the costs of our insurance, consulting fees and legal and accounting support. We expect our general and administrative expenses to increase as we expand our infrastructure in support of our anticipated increased operations, which we do not expect to occur earlier than the fourth quarter of 2004.

Our research and development expenses include contractual payments to RAND Corporation, consultants' fees, capital expenditures, cost of services and supplies. We expect our research and development costs to increase as we continue to develop the ZEFS and CAT-MATE devices and develop new applications of our technology.

Our non-cash settlement costs consist of the value of warrants to purchase an aggregate of 1,000,000 shares of common stock issued in payment of settlement fees, as determined by the Black-Scholes pricing model. We do not expect to incur further non-cash settlement costs.

We had a net loss of \$2,661,971 for the three months ended September 30, 2004, compared to a net loss of \$526,905 for the three months ended September 30, 2003. We had a net loss of \$4,602,129 for the nine months ended September 30, 2004, compared to a net loss of \$1,573,574 for the nine months ended September 30, 2003. These increases in loss are primarily attributable to an increase in research and

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development expenses as a result of the agreement we entered into with RAND Corporation in December 2002, as amended. We expect an increase in net loss through 2004 attributable to increased research and development, and general and administrative expenses, as well as the commencement of marketing activities.

Liquidity and Capital Resources

We have incurred negative cash flow from operations in the developmental stage since our inception in 1998. As of September 30, 2004 we had cash of \$223,102 and an accumulated deficit of \$14,929,737. Our 2004 negative operating cash flows have been funded primarily through the net proceeds of a private financing that we commenced in November 2002 and completed in October 2003. Because of our current cash position, the Company does not have sufficient cash on hand to continue to fund operations for any significant period of time. Accordingly, we commenced another private offering in late July 2004, which is ongoing. As of the date of the filing of this report, we have raised in excess of \$1 million in this offering. We anticipate additional operating losses, which may increase, through at least the remainder of 2004 as we expand our research and development program, provide for general and administrative expenses and commence marketing activities, without the benefit of revenue.

The accompanying 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 financial statements, for the nine month period ended September 30, 2004, the Company had a net loss of \$4,602,129 and a negative cash flow from operations of \$1,687,207, and as of September 30, 2004 had a working capital deficiency of \$585,902 and a stockholders' deficiency of \$1,563,271. These factors raise concerns about the Company's ability to continue as a going concern. The ability of the Company to continue as a going concern is dependent on the Company's ability to raise additional funds and implement its business plan. The financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

We believe that we have sufficient cash to fund our operations through at least the fourth quarter of 2004. In order to meet our operational needs, we are raising additional capital in a private offering as described above. However, there can be no assurance that additional financing will be available or, if it is available, that it will be available on terms that are favorable to the Company. If we are unable to obtain additional capital, we may be required to delay, reduce the scope of, or eliminate our research and development programs, or relinquish rights to technologies that we might otherwise seek to develop or commercialize.

In the action by the Securities and Exchange Commission (the "SEC") against Jeffrey Muller, the founder and former sole director of the Company, and others, we seek, among other relief, the cancellation of all shares of our common stock controlled, directly or indirectly, by Mr. Muller and his affiliates, options to purchase an additional 10,000,000 shares of our common stock, and Mr. Muller's original royalty agreement. See "Part II, Item 1, Legal Proceedings". The cancellation of these shares and options would have a significant positive effect on our capitalization.

Critical Accounting Policies

Our discussion and analysis of 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 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

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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 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. We believe the following critical accounting policies, among others, require significant judgments and estimates used in the preparation of our Financial Statements:

Stock-Based Compensation

Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123), establishes a fair value method of accounting for stock-based compensation plans and for transactions in which an entity acquires goods or services from non-employees in exchange for equity instruments. SFAS No. 123 also encourages, but does not require companies to record compensation cost for stock-based employee compensation. SFAS No. 123 was amended by SFAS No. 148, which now requires companies to disclose in interim financial statements the pro forma effect on net income (loss) and net income (loss) per common share of the estimated fair market value of stock options or warrants issued to employees. The Company has chosen to continue to account for stock-based compensation utilizing the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", with pro forma disclosures of net income (loss) as if the fair value method had been applied. Accordingly, compensation cost for stock options is measured as the excess, if any, of the fair market price of the Company's stock at the date of grant over the amount an employee must pay to acquire the stock.

We account for stock option and warrant grants issued to non-employees using the guidance of SFAS No. 123, "Accounting for Stock-Based Compensation" and 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," whereby the fair value of such option and warrant grants is determined using the Black-Scholes option pricing model at the earlier of the date at which the non-employee's performance is completed or a performance commitment is reached.

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 our financial statements as described in Note 1 of our Financial Statements. See Item 1, Part I, Financial Statements. Actual results could differ from those estimates.

New Accounting Pronouncements

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). The provisions of SFAS No. 150 are effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of nonpublic entities., which are subject to the provisions of this statement for the first fiscal period beginning after

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December 15, 2004. The Company believes that the adoption of SFAS No. 150 will not have an impact on its financial position or results of operations.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), which clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements", relating to consolidation of certain entities. In December 2003, the FASB issued a revised version of FIN 46 ("FIN 46R") that replaced the original FIN 46. FIN 46R requires identification of a company's participation in variable interest entities ("VIEs"), which are defined as entities with a level of invested equity that is not sufficient to fund future activities to permit it to operate on a standalone basis. For entities identified as a VIE, FIN 46R sets forth a model to evaluate potential consolidation based on an assessment of which party to the VIE, if any, bears a majority of the exposure to its expected losses, or stands to gain from a majority of its expected returns. FIN 46R also sets forth certain disclosures regarding interests in VIEs that are deemed significant even if consolidation is not required. The Company is not currently participating in, or invested in, any VIEs, as defined in FIN 46R. The implementation of the provisions of FIN 46R in 2003 did not have a significant effect on the Company's consolidated financial statement presentation or disclosures.

Item 3. Controls and Procedures

(a) 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 Quarterly Report on Form 10-QSB. 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(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")) are effective 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 Securities and Exchange Commission rules and forms. It should be noted that the design of any system of controls 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.

(b) Changes in internal control over financial reporting: There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-QSB that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II

Item 1. Legal Proceedings

On December 19, 2001, the SEC filed civil charges in the United States Federal District Court, Southern District of New York, against us, our former President and then sole board director Jeffrey A. Muller, and others, alleging that we and the other defendants were engaged in a fraudulent scheme to promote our stock. The SEC complaint alleged the existence of a promotional campaign using press releases, Internet postings, an elaborate website, and televised media events to disseminate false and materially misleading information as part of a fraudulent scheme to manipulate the market for stock in our corporation, which was then controlled by Mr. Muller. On March 22, 2002, we signed a Consent to Final Judgment of Permanent Injunction and Other Relief in settlement of this action as against the corporation only, which the court approved on July 2, 2002. Under this settlement, we were not required to admit fault and did not pay any fines or restitution. The SEC's charges of fraud and stock manipulation continues against Mr. Muller and others.

On July 2, 2002, after an investigation by our newly constituted board of directors, we filed a cross-complaint in the SEC action against Mr. Muller and others seeking injunctive relief, disgorgement of

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monies and stock and financial restitution for a variety of acts and omissions in connection with sales of our stock and other transactions occurring between 1998 and 2002. Among other things, we alleged that Mr. Muller and certain others sold company stock without providing adequate consideration to SWA; sold insider shares without making proper disclosures and failed to make necessary filings required under federal securities laws; engaged in self-dealing and entered into various undisclosed related-party transactions; misappropriated for their own use proceeds from sales of our stock; and entered into various undisclosed arrangements regarding the control, voting and disposition of their stock. We contend that we are entitled to a judgment cancelling all of the approximately 8,716,710 shares of our common stock which we believe are controlled, directly or indirectly, by Mr. Muller; divesting Mr. Muller of any right to exercise options for 10,000,000 shares of our stock, conversion of an existing preliminary injunction to a permanent injunction to prevent Mr. Muller from any involvement with the company and a monetary judgment against Muller and others in the amount of several million dollars. SWA is also seeking cancellation of the previous royalty arrangement with Mr. Muller.

On July 30, 2002, the U.S. Federal District Court, Southern District of New York, granted our application for a preliminary injunction against Mr. Muller and others, which prevents Mr. Muller and other cross-defendants from selling, transferring, or encumbering any assets and property previously acquired from SWA, from selling or transferring any of our stock that they may own or control, or from taking any action to injure us or our business and from having any direct contact with our shareholders. The injunctive order also prevents Mr. Muller from engaging in any effort to exercise control over our corporation and from serving as an officer or director of our company. While we believe that we have valid claims, there can be no assurance that an adverse result or settlement would not have a material adverse effect on our financial position or cash flow.

In the course of the litigation, we have obtained ownership control over Mr. Muller's claimed patent rights to the ZEFS device. Under a Buy-Sell Agreement between Jeffrey Muller and SWA dated December 29, 1998, Mr. Muller, who was listed on the ZEFS device patent application as the inventor of the ZEFS device, purported to grant SWA all international marketing, manufacturing and distribution rights to the ZEFS device. Those rights were disputed because an original inventor of the ZEFS device contested Muller's legal ability to have conveyed those rights. In Australia, Muller entered into a bankruptcy action seeking to overcome our claims for ownership of the ZEFS device. In conjunction with these litigation proceedings, a settlement agreement was reached whereby the \$10 per unit royalty previously due to Mr. Muller under his contested Buy-Sell Agreement was terminated and replaced with a \$.20 per unit royalty payable to the bankruptcy trustee. On November 7, 2002, under a settlement agreement executed with the Muller bankruptcy trustee, the trustee transferred all ownership and legal rights to this international patent application for the ZEFS device to us.

Both the SEC and SWA have filed Motions for Summary Judgment contending that there are no material issues of fact in contention and as a matter of law, the Court should grant a judgment against Jeffrey A. Muller and the cross-defendants. Muller has filed a response contending that the actions against him should be dismissed. A decision on these motions would potentially terminate the ongoing litigation. Further proceedings for all pretrial motions have been assigned to U.S. Magistrate Frank Maas. An initial decision will be made by Judge Maas after a hearing on the Motions which is expected to occur within the next 60 days. Should Judge Maas determine that there are material issues in dispute the case could be continued for a final disposition by a trial.

Although the outcome of this litigation cannot be predicted with any degree of certainty, we are optimistic that the Court's ruling will either significantly narrow the issues for any later trial or will result in a final disposition of the case in a manner favorable to the company. While we believe that we have valid claims, 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.

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Item 2. Changes in Securities

In July 2004, the Company issued warrants to purchase an aggregate of 500,000 shares of common stock to an advisor and his designees for settlement costs. The Company is also obligated to issue warrants to purchase an aggregate of 500,000 shares of common stock to the trustee in the Muller litigation for additional settlement costs.

In September 2004, the Company issued an aggregate of 50,000 shares of common stock to an advisor and his designees in exchange for advisory services provided to the Company.

In September 2004, the Company issued 20,000 shares of common stock to an individual in exchange for services rendered to the Company.

From July 2004 to September 2004, the Company issued an aggregate of 575,000 shares of common stock and warrants to purchase an aggregate of 575,000 shares of common stock to accredited investors. The aggregate consideration paid to the Company in connection with such issuances was \$575,000.

From July 2004 to September 2004, the Company sold, but did not issue, an aggregate of 125,000 shares of common stock to accredited investors. The shares were issued in November 2004. In connection with the investors' purchase, the Company issued warrants to purchase an aggregate of 125,000 shares of common stock. The aggregate consideration paid to the Company for such shares and warrants was \$125,000.

In August 2004, the Company issued 4,000 shares of common stock to an individual in connection with the exercise of warrants previously issued to him. The aggregate gross and net proceeds to the Company in connection with such exercises were \$2,000.

The issuance of the shares described above was made in reliance on the exemptions from registration set forth in Section 4(2) of the Securities Act of 1933, as amended. We made no public solicitation in connection with the issuance of the above-mentioned securities. We relied on representation from the purchasers of the securities that they purchased the securities for investment only and not with a view to any distribution thereof and that they were aware of our business affairs and financial condition and had sufficient information to reach an informed and knowledgeable decision regarding their acquisition of the securities.

Item 6. Exhibits and Reports on Form 8-K

(a)

<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).

(b) Reports on Form 8-K.

On July 12, 2004, we filed a Current Report on Form 8-K with the SEC, in connection with certain recent business developments.

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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: December 3, 2004

By: /s/ Edward L. Masry
Edward L. Masry
Chief Executive Officer

EXHIBIT INDEX

Exhibit No.	Description
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).

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, Edward L. Masry, 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 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: December 3, 2004

/s/ EDWARD L. MASRY

Edward L. Masry
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 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 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: December 3, 2004

/s/ EUGENE EICHLER

Eugene Eichler

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 Chief Executive Officer and 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 September 30, 2004 (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: December 3, 2004

/s/ EDWARD L. MASRY

Edward L. Masry
Chief Executive Officer

Date: December 3, 2004

/s/ EUGENE EICHLER

Eugene Eichler
Chief Financial Officer