

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-QSB**

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

For the quarterly period ended **SEPTEMBER 30, 2003**

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

Commission file number 033-03362-D

**KLEENAIR SYSTEMS, INC.**

(Exact name of small business issuer as specified in its charter)

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

87-0431043  
(I.R.S. Employer  
Identification #)

1711 Langley Avenue, Irvine CA 92614

(Address of principal executive offices)

(949) 955-3492

(Registrant's telephone number)

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

There were 23,049,661 shares of common stock, \$0.001 Par Value,  
outstanding as of October 17, 2003.

Transitional Small Business Disclosure Format (check one); Yes  No  [X]

KLEENAIR SYSTEMS, INC.

**FORM 10-QSB**

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## **PART I -- FINANCIAL INFORMATION**

### **Item 1. Financial Statements**

#### **REPORT ON REVIEW BY INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS**

Board of Directors,  
KleenAir Systems, Inc.  
Irvine, CA

We have reviewed the accompanying consolidated balance sheet of KleenAir Systems, Inc. (a development stage enterprise) (the "Company") as of September 30, 2003, and the related consolidated statements of operations for three and nine months, and stockholders' equity and cash flows for nine months ended September 30, 2003 and 2002. We have also reviewed the cumulative statements of operations, stockholders' equity and cash flows for the period from January 1, 1995 through September 30, 2003. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical review procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements for them to be in conformity with generally accepted accounting principles.

We have previously audited, in accordance with generally accepted auditing standards, the consolidated balance sheet as of December 31, 2002, and the related statements of operations, stockholders' equity and cash flows for the year then ended (not presented herein); and, in our report dated February 22, 2003, we expressed an opinion on those financial statements that was qualified based on the Company's ability to continue as a going concern. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2002 is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ Robert Early & Company  
ROBERT EARLY & COMPANY, P.C.  
Abilene, Texas

November 11, 2003

**KLEENAIR SYSTEMS, INC.**  
(A Development Stage Company)  
**CONSOLIDATED BALANCE SHEETS**

	September 30, 2003 <u>Unaudited</u>	December 31, 2002 <u></u>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash	\$ 61,241	\$ 76,758
Accounts receivable	147,610	12,542
Accounts receivable from related parties	207,036	50,000
Inventory-raw materials (at cost)	80,283	114,076
Notes receivable	120,000	220,000
Advances (net of allowance)	-	52,000
Prepaid expenses	<u>76,834</u>	<u>121,542</u>
<b>Total Current Assets</b>	<b>693,004</b>	<b>646,918</b>
<b>PROPERTY AND EQUIPMENT (net)</b>	<b>167,782</b>	<b>195,620</b>
<b>OTHER ASSETS:</b>		
Patent license (net)	<u>1,560,961</u>	<u>1,617,380</u>
<b>TOTAL ASSETS</b>	<b><u>\$ 2,421,747</u></b>	<b><u>\$ 2,459,918</u></b>
<b>LIABILITIES AND STOCKHOLDER'S EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable (\$48,059 and \$69,534 due to related parties, respectively)	\$ 549,444	\$ 150,176
Accrued expenses	22,688	-
Capital lease liability	1,462	4,811
Notes payable to related parties	173,000	50,000
Advances from directors	<u>96,584</u>	<u>95,850</u>
<b>Total Current Liabilities</b>	<b><u>843,178</u></b>	<b><u>300,837</u></b>
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock, series A, \$.001 par value (10,000,000 shares authorized, none outstanding)	-	-
Common stock, \$.001 par value (50,000,000 shares authorized, 22,884,661 and 20,270,556 outstanding, respectively)	22,885	20,271
Additional paid-in capital	7,313,156	6,959,717
Deficit accumulated during the development stage	<u>(5,757,472)</u>	<u>(4,820,907)</u>
<b>Total Stockholder's Equity</b>	<b><u>1,578,569</u></b>	<b><u>2,159,081</u></b>
<b>TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY</b>	<b><u>\$ 2,421,747</u></b>	<b><u>\$ 2,459,918</u></b>

See accompanying accountants' report and selected information.

**KLEENAIR SYSTEMS, INC.**  
(A Development Stage Company)  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
For Three and Nine Months Ended September 30, 2003 and 2002

	Three Months		Nine Months		Cumulative
	2003	2002	2003	2002	During Development Stage
REVENUES	\$ 655,192	\$ 7,332	\$ 893,255	\$ 32,544	\$ 1,068,278
Cost of goods sold	<u>414,709</u>	<u>7,511</u>	<u>610,024</u>	<u>23,446</u>	<u>660,485</u>
Gross Profit	<u>240,483</u>	<u>(179)</u>	<u>283,231</u>	<u>9,098</u>	<u>407,793</u>
PRODUCT DEVELOPMENT COSTS	<u>20,853</u>	<u>93,491</u>	<u>128,240</u>	<u>240,600</u>	<u>1,170,711</u>
OPERATING EXPENSES:					
Personnel costs and director fees	75,528	51,042	87,638	91,142	754,937
Consultants	117,437	56,918	316,974	168,752	2,360,904
Professional fees	17,773	133,638	87,566	166,151	483,257
Office expenses	2,399	5,578	15,069	11,201	58,432
Depreciation	12,445	10,611	36,871	23,651	98,701
Amortization of intangible assets	36,466	-	85,599	-	151,110
Advertising and promotion	25,884	71,631	125,746	169,085	337,510
Loss on cancellation of license agreements	-	-	-	-	19,860
Rent	24,041	14,365	71,380	40,750	185,880
Travel	20,721	20,447	82,580	65,766	282,578
Other expenses	15,594	42,592	69,100	73,410	159,721
Bad debts	-	-	100,000	-	100,000
Unknown - prior to current ownership	-	-	-	-	151,518
Total operating expenses	<u>348,288</u>	<u>406,822</u>	<u>1,078,523</u>	<u>809,908</u>	<u>5,144,408</u>
(LOSS) FROM OPERATIONS	(128,658)	(500,492)	(923,532)	(1,041,410)	(5,907,326)
OTHER INCOME AND (EXPENSES):					
Interest income	1	7	11	10	2,526
Interest expense	(4,434)	(203)	(13,044)	(1,140)	(15,233)
Amortization of discount on receivables	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>20,259</u>
(Loss) before income taxes	(133,091)	(500,688)	(936,565)	(1,042,540)	(5,899,774)
Benefit from deferred taxes	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>397,852</u>
<b>(Loss) Before Extraordinary Item</b>	<b>(133,091)</b>	<b>(500,688)</b>	<b>(936,565)</b>	<b>(1,042,540)</b>	<b>(5,501,922)</b>
Extraordinary Item:					
Costs of terminated acquisition	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(255,550)</u>
Net (Loss)	<u>\$ (133,091)</u>	<u>\$ (500,688)</u>	<u>\$ (936,565)</u>	<u>\$ (1,042,540)</u>	<u>\$ (5,757,472)</u>
Basic and Diluted Earnings Per Share:					
(Loss) per share before extraordinary item	\$ (0.01)	\$ (0.03)	\$ (0.04)	\$ (0.06)	\$ (0.69)
(Loss) per share from extraordinary item	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(0.03)</u>
Net (Loss) Per Share	<u>\$ (0.01)</u>	<u>\$ (0.03)</u>	<u>\$ (0.04)</u>	<u>\$ (0.06)</u>	<u>\$ (0.72)</u>
Weighted Average Shares Outstanding	<u>22,202,549</u>	<u>18,401,894</u>	<u>21,168,143</u>	<u>17,171,514</u>	<u>8,025,116</u>

See accompanying accountants' report and selected information.

**KLEENAIR SYSTEMS, INC.**  
(A Development Stage Company)  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Preferred Stock		Common Stock		Additional Paid-In Capital	Unearned Compensation	Accumulated Deficit During Development Stage
	Shares	Amount	Shares	Amount			
BALANCES, 1/1/95	-	\$ -	74,132	\$ 74	\$ 151,444	\$ -	\$ (151,518)
Stock issued: For cash	-	-	27,334	27	66,982	-	-
For adjustment	-	-	534	1	-	-	-
For consulting services	-	-	86,148	86	279,439	-	-
For professional services	-	-	4,666	5	12,745	-	-
For purchase of patent rights	933,334	934	60,000	60	13,905	-	-
For directors' compensation	-	-	4,000	4	22,496	-	-
For officers' compensation	33,334	33	9,334	9	194,958	-	-
Other contributed capital	-	-	-	-	2,367	-	-
Options compensation	-	-	-	-	70,313	(152,016)	-
Net loss	-	-	-	-	-	-	(329,289)
BALANCES, 12/31/95	966,668	967	266,148	266	814,649	(152,016)	(480,807)
Stock issued for services	13,332	13	24,666	25	201,837	(78,750)	-
For officers' compensation	33,332	33	-	-	15,592	(15,625)	-
For aborted acquisition	-	-	40,000	40	140,510	-	-
Exercise of options	-	-	75,000	75	112,424	-	-
Conversion to common	(318,666)	(319)	318,666	319	-	-	-
Net Loss	-	-	-	-	-	187,346	(716,511)
BALANCES, 12/31/96	694,666	694	724,480	725	1,285,012	(59,045)	(1,197,318)
Stock issued: For cash	-	-	120,000	120	14,880	-	-
For officers' compensation	33,334	33	-	-	3,842	(3,875)	-
Conversion to common	(100,000)	(100)	100,000	100	-	-	-
Net loss	-	-	-	-	-	37,979	(55,438)
BALANCES, 12/31/97	628,000	627	944,480	945	1,303,734	(24,941)	(1,252,756)

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See accompanying accountants' report and selected information.

**KLEENAIR SYSTEMS, INC.**  
(A Development Stage Company)  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(Continued from previous page)

	Preferred Stock		Common Stock		Additional Paid-In Capital	Unearned Compen- sation	Accumulated Deficit During Development Stage
	Shares	Amount	Shares	Amount			
Stock issued: For cash	-	\$ -	\$ 800,000	\$ 800	\$ 199,200	\$ -	\$ -
For services	-	-	2,120,000	2,120	92,255	-	-
For officer/director services	-	-	320,000	320	59,680	-	-
For diesel license	-	-	2,000,000	2,000	60,500	-	-
Conversion to common	(403,334)	(403)	403,334	403	-	-	-
Net loss	-	-	-	-	-	24,941	(305,561)
<b>BALANCES, 12/31/98</b>	<b>224,666</b>	<b>224</b>	<b>6,587,814</b>	<b>6,588</b>	<b>1,715,369</b>	<b>-</b>	<b>(1,558,317)</b>
Stock issued: For cash	-	-	146,800	147	35,653	-	-
For services	-	-	1,103,334	1,103	247,179	-	-
For equipment	-	-	33,200	33	8,267	-	-
For officer/director services	-	-	1,425,000	1,425	408,808	-	-
Conversion to common	(61,334)	(61)	61,334	61	-	-	-
Net loss	-	-	-	-	-	-	(802,722)
<b>BALANCES, 12/31/99</b>	<b>163,332</b>	<b>163</b>	<b>9,357,482</b>	<b>9,357</b>	<b>2,415,276</b>	<b>-</b>	<b>(2,361,039)</b>
Stock issued: For cash	-	-	1,414,000	1,414	357,336	-	-
For services	-	-	1,642,666	1,643	600,024	-	-
As promotion	-	-	1,600	2	3,199	-	-
Conversion to common	(163,332)	(163)	163,334	163	-	-	-
Net loss	-	-	-	-	-	-	(717,012)
<b>BALANCES, 12/31/00</b>	<b>-</b>	<b>-</b>	<b>12,579,082</b>	<b>12,579</b>	<b>3,375,835</b>	<b>-</b>	<b>(3,078,051)</b>

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See accompanying accountants' report and selected information.

**KLEENAIR SYSTEMS, INC.**  
(A Development Stage Company)  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(Continued from previous page)

	Preferred Stock		Common Stock		Additional Paid-In Capital	Unearned Compen- sation	Accumulated Deficit During Development Stage
	Shares	Amount	Shares	Amount			
Stock issued: For cash	-	\$ -	\$ 195,000	\$ 195	\$ 104,805	\$ -	\$ -
For services	-	-	1,749,487	1,749	293,087	-	-
For officer/director services	-	-	850,000	850	77,690	-	-
For rent	-	-	17,500	18	6,232	-	-
Net loss	-	-	-	-	-	-	(623,811)
BALANCES, 12/31/01	-	-	15,391,069	15,391	3,857,649	-	(3,701,862)
Stock issued: For cash	-	-	2,804,545	2,805	1,717,195	-	-
For services	-	-	1,201,692	1,202	404,232	-	-
For Acquisition of Carbon Cloth	-	-	873,250	873	968,434	-	-
Contributed inventory	-	-	-	-	12,207	-	-
Net loss	-	-	-	-	-	-	(1,119,045)
BALANCES, 12/31/02	-	-	20,270,556	20,271	6,959,717	-	(4,820,907)
Stock issued:							
For cash	-	-	500,000	500	49,500	-	-
For services	-	-	1,320,299	2,114	303,939	-	-
Net loss	-	-	-	-	-	-	(936,565)
BALANCES, 09/30/03	-	\$ -	<u>21,064,362</u>	<u>\$ 22,885</u>	<u>\$ 7,313,156</u>	<u>\$ -</u>	<u>\$ (5,757,472)</u>

See accompanying accountants' report and selected information.

**KLEENAIR SYSTEMS, INC.**  
(A Development Stage Company)  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
For Nine Months Ended September 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>	<u>Cumulative During Devel- opment Stage</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net (loss)	\$ (936,565)	\$ (1,042,540)	\$ (5,757,472)
Adjustments to reconcile net income/(loss) to net cash provided by operations:			
Losses prior to current ownership	-	-	151,518
Depreciation	36,872	23,651	98,702
Amortization of:			
Intangibles	85,599	-	151,110
Prepaid expenses	117,750	141,750	1,206,445
Stock issued for services	200,000	192,147	2,040,642
Stock issued for extraordinary loss	-	-	140,550
Deferred income taxes	-	-	(397,852)
Bad debts	100,000	-	100,000
Changes in operating assets and liabilities:			
Accounts and note receivable	(240,104)	(226,753)	(332,249)
Advances to consultants	-	-	20,000
Inventory	33,793	(116,161)	(57,745)
Prepaid expenses	(11,542)	(53,850)	(258,542)
Accounts payable and accrued expenses	466,509	(94,498)	520,541
<b>NET CASH USED BY OPERATING ACTIVITIES</b>	<u>(147,688)</u>	<u>(1,176,254)</u>	<u>(2,374,352)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Property and equipment	(9,034)	(159,448)	(256,791)
Patent licensing costs	(29,180)	(72,017)	(160,668)
Business acquisition	-	-	(44,820)
Notes receivable	-	-	(220,000)
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<u>(38,214)</u>	<u>(231,465)</u>	<u>(682,279)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from issuing stock	50,000	1,650,000	2,844,459
Additional capital contributions	-	-	2,367
Capital lease obligation	-	-	7,765
Payments on capital lease	(3,349)	(2,334)	(6,303)
Proceeds from loans from related parties	123,000	-	173,000
Advances from directors	734	-	96,584
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<u>170,385</u>	<u>1,647,666</u>	<u>3,117,872</u>
<b>NET INCREASE/(DECREASE) IN CASH</b>	(15,517)	239,947	61,241
<b>CASH AT BEGINNING OF YEAR</b>	<u>76,758</u>	<u>33,479</u>	<u>-</u>
<b>CASH AT END OF PERIOD</b>	<u>\$ 61,241</u>	<u>\$ 273,426</u>	<u>\$ 61,241</u>

**SUPPLEMENTAL DISCLOSURES**

See Note 4.

See accompanying accountants' report and selected information.

**KLEENAIR SYSTEMS, INC.**  
(A Development Stage Enterprise)  
**SELECTED INFORMATION FOR CONSOLIDATED FINANCIAL STATEMENTS**  
September 30, 2003  
(Unaudited)

**NOTE 1: BASIS OF PRESENTATION**

The accompanying unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions of Regulation S-B. They do not include all information and footnotes required by generally accepted accounting principles for complete financial statements. However, except as disclosed herein, there has been no material change in the information included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2002. In the opinion of Management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The report of Robert Early & Company, P.C. commenting on their review accompanies the financial statements included in Item 1 of Part 1. Operating results for the nine-month period ended September 30, 2003, are not necessarily indicative of the results that may be expected for the year ending December 31, 2003.

**NOTE 2: PROPERTY AND EQUIPMENT**

The Company has purchased testing equipment, test vehicles, and office equipment and furniture as presented in the following table. Depreciation expense for the first three quarters of 2003 and 2002 was \$36,872 and \$23,651, respectively.

Office furniture and equipment	\$	61,496
Test vehicles		28,928
Analysis equipment		166,493
Leasehold improvements		<u>11,682</u>
		268,599
Accumulated depreciation		<u>(100,817)</u>
Net property & equipment	\$	<u>167,782</u>

**NOTE 3: PREPAID EXPENSES AND AMORTIZATION**

The Company frequently prepays for services to be rendered either in cash or by stock issuance. These transactions are recorded as prepaid expenses and amortized over the period covered by the agreement. These amortized costs were included in "Advertising and promotion," although this is not necessarily true for the cumulative amounts presented. Amortization totaled \$117,750 and \$141,750 in the nine months ended September 30, 2003 and 2002, respectively.

**NOTE 4: SUPPLEMENTAL CASH FLOW DISCLOSURES**

The following table sets forth supplemental cash flow disclosures.

	<u>2003</u>	<u>2002</u>	<u>Cumulative During Devel- opment Stage</u>
Cash payments for:			
Interest	\$ 5,356	\$ 1,140	\$ 7,545
Income taxes	-	-	-

	<u>2003</u>	<u>2002</u>	<u>Cumulative During Devel- opment Stage</u>
Non-cash investing and financing transactions:			
Stock issued for:			
Compensation and directors fees	\$ 65,340	\$ 59,188	\$ 884,900
Services and prepaid services	240,713	223,709	1,931,470
Equipment	-	-	8,300
Patent licensing	-	-	14,900
Repurchase of U.S. diesel license	-	-	62,500
Acquisition of National Diversified Telecom, Inc.	-	-	140,550
Sale of marketing licenses for notes receivable	-	-	1,736,558
Acquisition of Carbon Cloth Technologies, Inc.	-	-	981,514
Uncompleted business acquisition	-	-	87,500

#### **NOTE 5: STOCK TRANSACTIONS**

During the first quarter of 2003, the Company issued 100,000 restricted shares valued at \$30,750 for financial consulting services. Another 115,000 unrestricted S-8 shares valued at \$35,475 were issued to consultants for business promotion and financial consulting services. The Company also issued 71,522 unrestricted S-8 shares valued at \$21,641 for research and development services and sales promotion.

During the second quarter of 2003, the Company issued 82,500 restricted shares and 50,000 S-8 shares valued at \$24,413 for an agreement regarding release of certain patent licensing. A total of 171,151 S-8 shares valued at \$40,635 were issued for business promotion and consulting services. Another 178,932 S-8 shares were issued as compensation for legal services which had been billed at \$44,553.

During the third quarter of 2003, the Company issued 200,000 unrestricted S-8 shares valued at \$36,750 for financial consulting services. Another 45,000 unrestricted S-8 shares valued at \$6,495 were issued for research and development and as compensation. A total of 1,100,000 restricted shares valued at \$65,340 were issued to directors as compensation for their continued services to the Company. An officer purchased 500,000 restricted shares for \$50,000.

#### **NOTE 6: NOTES RECEIVABLE**

During the first quarter of 2002, the Company lent \$120,000 to a licensee. During the third quarter of 2002, the Company lent another \$100,000 to this licensee. These loans were collateralized by stock of the Company held by the licensee. During the fourth quarter of 2002, the licensee assigned the \$120,000 loan along with the underlying collateral to a consultant for the Company. In March 2003, the final settlement of a dispute and lawsuit between the entities resulted in the forgiveness of the \$100,000 loan. This debt forgiveness has been recorded as "Bad debts."

#### **NOTE 7: ACCOUNTS RECEIVABLE FROM RELATED PARTIES**

This balance consists of the elements presented below. KleenAir Systems International LTD. (KASI) is partially owned by the Company and controlled by the Company's President. Nox Masters LTD. is wholly owned by KASI. The \$133,299 and the \$6,250 represent sales of particulate traps and NoxMaster™ systems for resale and installation on British vehicles. The \$45,000 is billings for equipment and support services during the testing phases leading to approval of the systems in the U.K. The \$22,000 is for patent royalties.

KleenAir Systems International LTD.	\$ 133,299
KleenAir Systems LTD.	6,250
KleenAir Systems LTD.	22,000
KleenAir Systems LTD.	45,000
Advances to employees	487
Total	<u>\$ 207,036</u>

**NOTE 8: NOTE PAYABLE TO RELATED PARTIES**

During the first and second quarters of 2003, officers and entities related to them loaned the Company \$90,000 and \$33,000, respectively. These loans bear interest at 7% compounded monthly and are due on demand.

**NOTE 9: SUBSEQUENT EVENTS**

During October 2003, the Company has issued 115,000 S-8 shares to a consultant for financial representation and advisory services with potential additional shares, based on performance.

The Company has additional orders for sales of particulate traps and NOxMaster™ systems from its U.K. affiliate, who is reselling them to a distributor. The Company also is in the midst of an series of orders to provide its CarbonGuard™ system, which has been designated a "single-source product" for retrofitting city buses in New York.

## Item 2. Management's Discussion and Plan of Operation

The Company was incorporated under the laws of the State of Nevada on February 4, 1986, under the name of Covington Capital Corporation. In 1986, the Company filed an S-18 and registered certain stock. From 1989 through 1993, the Company underwent a series of name changes in order to explore various business opportunities. However, none of the business opportunities was successfully completed.

In April, 1995, under the name Investment and Consulting International, Inc., the Company acquired a patent for a proprietary device designed to neutralize nitrogen oxide automobile emissions from a separate company which was then known as KleenAir Systems, Inc. Simultaneously with the acquisition of the patent, the Company acquired the right to use the corporate name KleenAir Systems, Inc., and changed to its current name.

Since acquiring the patent in 1995, the Company has been a developmental stage company and has worked towards the completion of the development and testing of the NOxMaster™ technology. The Company owns U.S. Patent # 5,224,346 Engine NOx Reduction System issued in 1993, U.S. Patent # 5,609,026 Engine NOx Reduction issued in 1997. In 1999 the Company was issued a third patent on Ammonia Injection in NOx Control, U.S. Patent # 5,992,141. The Company has applied for and maintained patent protection under the Patent Cooperation Treaty (PCT) to protect its intellectual property in a variety of countries that are significant producers of automotive products.

The Company has applied for additional patents related to its NOxMaster™ technology, two of which have been granted. The U.S. Patent # 6,446,940 has been issued for a new emission control device, the Sonic Flow Carburetor, which atomizes fuel on gasoline powered engines, enhancing operating efficiency and reducing emissions. An additional U.S. Patent # 6,499,463 has been issued for a device which atomizes diesel fuel to enhance the performance of and reduce emissions in diesel engines.

The Company occupies 10,000 square foot R & D facilities at 1711 Langley, Irvine, CA 92614. The Company has a new chassis dynamometer in addition to its engine dynamometer to cope with increasing levels of R & D engine and device testing programs as it prepares for commercializing its technology.

The Company has completed the final phase of its London Taxi Program funded by a U.K. government grant and been advised that KleenAir is now approved for the Clean-Up Register of the Energy Savings Trust for all light duty applications. Test systems have been installed on a Dennis refuse collection truck and a Mercedes-Benz Sprinter 16 passenger bus operated by the Borough of Hounslow in London. An Energy savings Trust grant has been awarded for a test and evaluation program on both these vehicles. Final emissions tests were conducted on the Sprinter and application has been made to have it included for medium duty vehicles on the Clean-Up Register. Patent awards have now been confirmed for several European countries including the U.K., Germany, France, Italy, Spain and Sweden, and anticipated soon for Japan, Brazil, and China.

Distribution arrangements have been concluded through the Company's U.K. affiliate with Dinex A/S of Denmark and Dinex Exhaust Systems Ltd of the U.K. for the KleenAir product line. Dinex specializes in after-market sales of particulate filters, silencers and exhaust system components for medium and heavy-duty diesel-powered vehicles. Initial orders for \$150,000 were delivered to Dinex during the second quarter, and \$400,000 worth of orders were shipped during the third quarter. Additional significant orders are anticipated in the coming months.

The Energy Savings Trust has awarded an additional grant to Dinex and KleenAir to test a combination system that includes a particulate filter and the NOxMaster™ NOx reduction system together with the CarbonGuard™ thermal management system on a London taxi. It is believed that this combination will meet the new emission target for London taxis being required under the Mayor of London's new emission reduction strategy.

U.S. testing continues of the NOxMaster™ Diesel Catalytic Converter together with its NOxMaster™ Ammonia Injection System to present an integrated system for the elimination of emissions from diesel powered mobile sources. The Company has received an EO certification from the California Air Resources Board (CARB) for off-road and stationary engine applications, which will enable it to commence sales of its products in California..

The Company has now received approval from CARB for its applications for Retrofit Verification for heavy-duty vehicles using its NOxMaster™ NOx reduction system. Approval has also been received from the EPA to proceed with an application for certification of the combination package of its Oxidizing Particulate Trap (OPT) with the NOxMaster™ for both high particulate reduction as well as high NOx reduction. The Company is preparing for a

50,000 mile durability test under the EPA and CARB programs that will, hopefully, be completed by year-end or early in 2004.

The Company's wholly owned subsidiary, Carbon Cloth Technologies, Inc. (Carbon Cloth), of Malibu, California, is a manufacturer of automotive thermal management systems. Carbon Cloth has several years of experience developing thermal solutions for such motorsports industry leaders as Ferrari, Mercedes-Benz and Penske, that has enabled development of the CarbonGuard™, a significant addition to the battle on pollution. It has applied for patents in automotive thermal management systems. At present the CarbonGuard™ is used to enhance the effectiveness of particulate filters. These filters need to maintain 300 degrees centigrade for 30% of a vehicle's operating time otherwise the filters clog and create back pressure. Wherever particulate filters are currently installed, estimated to be at least 30,000 units at present, the CarbonGuard™ can improve performance and save maintenance expense. Filter technology has come to prominence recently as both the Environmental Protection Agency (EPA) and the California Air Resource Board (CARB) have determined that particulates from vehicle emissions are a serious public health problem.

Carbon Cloth has shipped orders of approximately \$200,000 to Johnson Matthey, Inc. and is anticipating an additional \$50,000 in shipments during the fourth quarter. These systems are intended as retrofits on 600 New York City Transit Buses to help improve performance of particulate filters being installed. The CarbonGuard™ is already installed on a number of New York City Transit Authority buses as enhancements for the operating efficiency of its installed base of particulate traps. It has been selected as a sole source product for this application. A further several hundred buses are anticipated to be upgraded with the CarbonGuard™. It is expected that this product will generate meaningful revenues over the next few months and will make a significant contribution toward covering the Company's overhead expenses. Negotiations are being held with a number of automotive OEM manufacturers to incorporate our CarbonGuard™ for a variety of thermal management applications.

The acquisition agreement with ServoTech Engineering Inc. did not close as anticipated in February. Discussions are ongoing as to the nature of the future relationship. In the meantime, the Company is continuing its sales activities on behalf of the SOBRIS™ system under an agency agreement signed in July 2002. ServoTech is a licensee of Ford Motor Company on SCR injection technology. Its SOBRIS™ product is under test and evaluation by a number of automotive manufacturers in the U.S. and Europe. Dr. Hamid Servati, President of ServoTech and a director of the Company, has purchased an additional 500,000 shares of restricted common stock from the Company. This increases his holdings to 1,250,000 shares. The Company and ServoTech continue to negotiate a more permanent relationship between the two entities.

Once production and sales begin, the Company anticipates employing initially 15 to 20 employees, primarily in management, technical and administrative capacities. The Company is actively seeking sources of funding for its operating capital requirements both to complete its test and evaluation programs and to support initial sales and production.

The Company is negotiating potential licensing and other commercial arrangements with certain international companies in the automotive industry, subject to completion of satisfactory test and evaluation programs.

#### Disclosure Regarding Forward-Looking Statements

Where this Form 10-QSB includes "forward-looking" statements within the meaning of Section 27A and Section 21E of the Securities Act, the Company desires to take advantage of the "safe harbor" provisions thereof. Therefore, the Company is including this statement for the express purpose of availing itself of the protections of such safe harbor provisions with respect to all of such forward-looking statements. The forward-looking statements in this Form 10-QSB reflect the Company's current views with respect to future events and financial performance. These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ from those anticipated. These risks include, but are not limited to, economic conditions, changes in environmental regulations, the market for venture capital, etc. In this Form 10-QSB, the words "anticipates," "believes," "expects," "intends," "future" and similar expressions identify forward-looking statements. The Company undertakes no obligation to publicly revise these forward-looking statements to reflect events or circumstances that may arise after the date hereof. All subsequent written and oral forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by this section.

### Item 3: Controls and Procedures

- (a) Within the 90-day period prior to the date of this report, the Corporation carried out an evaluation, under the supervision and with the participation of the Company's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Corporation's disclosure controls and procedures are effective in timely alerting him to material information relating to the Corporation (including its consolidated subsidiaries) required to be included in the Corporation's Exchange Act filings.
- (b) There have been no significant changes in the Corporation's internal controls or in other factors which could significantly affect its internal controls subsequent to the date the Corporation carried out its evaluation.

## PART II - OTHER INFORMATION

### Item 6. Exhibits and Reports on Form 8-K.

Exhibit 23 -- Accountants' consent to incorporation by reference

Exhibit 99.1 -- Certification Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Reports on Form 8-K — None

### SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

KLEENAIR SYSTEMS, INC.

Date: November 13, 2003

/s/ LIONEL SIMONS

By: Lionel Simons, President,  
Secretary, Principal Accounting Officer, &  
Principal Financial Officer

## CERTIFICATION

I, Lionel Simons, President and Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of KleenAir Systems, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit 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 quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and I have:
  - (a) designed such disclosure controls and procedures 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 quarterly report is being prepared;
  - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - (c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing equivalent function):
  - (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 13, 2003

/s/ LIONEL SIMONS

Lionel Simons  
President and  
Chief Financial Officer