

U.S. Securities and Exchange Commission  
Washington, D.C. 20549

**FORM 10-QSB**

(Mark One)

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

For the quarterly period ended **SEPTEMBER 30, 2002**

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

Commission file number 33-3362-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)

There were 19,150,365 shares of common stock, \$0.001 Par Value,  
outstanding as of September 30, 2002.

Transitional Small Business Disclosure Format (check one); Yes ☐ No ☒

## **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, 2002, and the related consolidated statements of operations, stockholders' equity, and cash flows for the three and nine months ended September 30, 2002 and 2001. We have also reviewed the cumulative statements of operations, stockholders' equity and cash flows for the period from January 1, 1995 through September 30, 2002. 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 balance sheet as of December 31, 2001, and the related statements of operations, stockholders' equity and cash flows for the year then ended (not presented herein); and, in our report dated April 9, 2002, 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 condensed consolidated balance sheet as of December 31, 2000 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, 2002

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

	September 30, 2002 <u>Unaudited</u>	December 31, 2001 <u></u>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash	\$ 273,426	\$ 33,479
Accounts receivable	24,750	1,600
Receivable from affiliates	36,000	-
Inventory	140,983	-
Note receivable	150,000	-
Prepaid expenses	<u>76,512</u>	<u>119,862</u>
Total Current Assets	701,671	154,941
 PROPERTY AND EQUIPMENT (net)	 200,191	 55,237
 <b>OTHER ASSETS:</b>		
Patent license	1,542,232	152,781
Loan to employee	40,000	-
Security deposit	<u>46,200</u>	<u>-</u>
Total Other Assets	<u>1,628,432</u>	<u>152,781</u>
 <b>TOTAL ASSETS</b>	 <u><u>\$ 2,530,294</u></u>	 <u><u>\$ 362,959</u></u>
 <b>LIABILITIES AND STOCKHOLDER'S EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable (\$67,534 and \$74,899 due to related parties, respectively)	\$ 97,577	\$ 95,931
Advances from directors	95,850	95,850
Capital lease liability	<u>5,431</u>	<u>-</u>
Total Current Liabilities	<u>198,858</u>	<u>191,781</u>
 <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, 19,150,365 and 15,391,069 outstanding, respectively)	19,150	15,391
Additional paid-in capital	7,056,688	3,857,649
Deficit accumulated during the development stage	<u>(4,744,402)</u>	<u>(3,701,862)</u>
Total Stockholder's Equity	<u>2,331,436</u>	<u>171,178</u>
 <b>TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY</b>	 <u><u>\$ 2,530,294</u></u>	 <u><u>\$ 362,959</u></u>

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, 2002 and 2001

	Three Months		Nine Months		Cumulative During Devel- opment Stage
	2002	2001	2002	2001	
REVENUES:					
Sale of product license	\$ 7,332	\$ 51,650	\$ 32,544	\$ 113,901	\$ 151,732
Services	-	-	-	4,600	4,600
Total Revenues	<u>7,332</u>	<u>51,650</u>	<u>32,544</u>	<u>118,501</u>	<u>156,332</u>
COST OF GOODS SOLD	<u>7,511</u>	<u>-</u>	<u>23,446</u>	<u>-</u>	<u>23,446</u>
Gross Profit	<u>(179)</u>	<u>51,650</u>	<u>9,098</u>	<u>118,501</u>	<u>132,886</u>
PRODUCT DEVELOPMENT COSTS	<u>93,491</u>	<u>57,060</u>	<u>240,600</u>	<u>129,317</u>	<u>945,298</u>
OPERATING EXPENSES:					
Personnel costs and director fees	51,042	59,188	91,142	59,188	673,744
Consultants	56,918	7,435	168,752	12,424	1,773,497
Professional fees	133,638	5,154	166,151	13,588	399,566
Office expenses	5,578	282	11,201	721	36,826
Depreciation	10,611	3,889	23,651	11,367	52,266
Advertising and promotion	71,631	795	169,085	179,705	323,297
Loss on cancellation of licensing agreements	-	-	-	-	19,860
Rent	14,365	3,750	40,750	17,500	92,000
Other expenses	63,039	1,177	139,176	33,697	262,995
Unknown sources prior to current ownership	-	-	-	-	151,518
Total operating expenses	<u>406,822</u>	<u>81,670</u>	<u>809,908</u>	<u>328,190</u>	<u>3,785,569</u>
(LOSS) FROM OPERATIONS	(500,492)	(87,080)	(1,041,410)	(339,006)	(4,597,981)
OTHER INCOME AND (EXPENSES):					
Interest income	7	8	10	69	2,510
Interest expense	(203)	-	(1,140)	-	(1,140)
Amortization of discount on receivables	-	-	-	-	20,259
<b>(Loss) Before Extraordinary Item</b>	<b>(500,688)</b>	<b>(87,072)</b>	<b>(1,042,540)</b>	<b>(338,937)</b>	<b>(4,576,352)</b>
Extraordinary Item:					
Costs of terminated acquisition	-	-	-	-	(168,050)
Net (Loss)	<u>\$ (500,688)</u>	<u>\$ (87,072)</u>	<u>\$ (1,042,540)</u>	<u>\$ (338,937)</u>	<u>\$ (4,744,402)</u>
Basic earnings per share:					
(Loss) Per Share Before Extraordinary Item	\$ (0.03)	\$ (0.01)	\$ (0.06)	\$ (0.03)	\$ (0.72)
(Loss) Per Share From Extraordinary Item	-	-	-	-	(0.02)
Net (Loss) Per Share	<u>\$ (0.03)</u>	<u>\$ (0.01)</u>	<u>\$ (0.06)</u>	<u>\$ (0.03)</u>	<u>\$ (0.74)</u>
Weighted Average Shares Outstanding	<u>18,401,894</u>	<u>12,995,502</u>	<u>17,171,514</u>	<u>12,719,414</u>	<u>6,387,945</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	Unearned	Accumulated
	Shares	Amount	Shares	Amount	Paid-In Capital	Compensation	Deficit During Development Stage
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	Unearned	Accumulated
	Shares	Amount	Shares	Amount	Paid-In Capital	Compensation	Deficit During Development Stage
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)
BALANCES, 12/31/98	224,666	224	6,587,814	6,588	1,715,369	-	(1,558,317)
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)
BALANCES, 12/31/99	163,332	163	9,357,482	9,357	2,415,276	-	(2,361,039)
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)
BALANCES, 12/31/00	-	-	12,579,082	12,579	3,375,835	-	(3,078,051)
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)

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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	Unearned	Accumulated
	Shares	Amount	Shares	Amount	Paid-In Capital	Compen- sation	Deficit During Development Stage
Stock issued for cash	-	-	2,454,545	2,455	1,647,545	-	-
For services	-	-	471,501	471	304,626	-	-
Acquisition of Carbon Cloth	-	-	833,250	833	1,232,377	-	-
Contributed inventory	-	-	-	-	14,491	-	-
Net loss	-	-	-	-	-	-	(1,042,540)
BALANCES, 09/30/02	-	\$ -	19,150,365	\$ 19,150	\$ 7,056,688	\$ -	\$ (4,744,402)

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, 2002 and 2001

	<u>2002</u>	<u>2001</u>	<u>Cumulative During Devel- opment Stage</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net (loss)	\$(1,042,540)	\$ (338,937)	\$ (4,744,402)
Adjustments to reconcile net income/(loss) to net cash provided by operations:			
Losses prior to current ownership	-	-	151,518
Depreciation	23,651	11,367	51,902
Amortization of:			
Prepaid expenses	141,750	198,125	809,908
Deferred services	-	-	250,267
Stock issued for services	192,147	101,534	1,753,105
Stock issued for extraordinary loss	-	-	140,550
Changes in operating assets and liabilities:			
Accounts and note receivable	(226,753)	44,807	(208,353)
Inventory	(116,161)	(22,133)	(116,161)
Prepaid expenses	(53,850)	-	(254,650)
Trade accounts payable	(94,498)	(14,006)	1,433
<b>NET CASH USED BY OPERATING ACTIVITIES</b>	<u>(1,176,254)</u>	<u>(19,243)</u>	<u>(2,164,883)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Property and equipment	(159,448)	(3,629)	(234,635)
Patent and licensing costs	(72,017)	(6,264)	(147,398)
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<u>(231,465)</u>	<u>(9,893)</u>	<u>(382,033)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from issuing stock	1,650,000	18,000	2,724,459
Payments on capital lease	(2,334)	-	(2,334)
Additional capital contributions	-	-	2,367
Advances from directors	-	-	95,850
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<u>1,647,666</u>	<u>18,000</u>	<u>2,820,342</u>
<b>NET INCREASE/(DECREASE) IN CASH</b>	239,947	(11,136)	273,426
<b>CASH AT BEGINNING OF YEAR</b>	<u>33,479</u>	<u>24,365</u>	<u>-</u>
<b>CASH AT END OF PERIOD</b>	<u><u>\$ 273,426</u></u>	<u><u>\$ 13,229</u></u>	<u><u>\$ 273,426</u></u>
<b>SUPPLEMENTAL DISCLOSURES:</b>			
Cash payments for:			
Interest	\$ 1,140	\$ -	\$ 1,140
Income taxes	-	-	-
Non-cash investing and financing transactions:			
Stock issued for:			
Compensation and directors fees	59,188	59,188	667,196
Services and prepaid services	223,709	42,346	1,579,740
Equipment	-	-	8,300
Patent licensing (Carbon Cloth, Inc. acquisition)	1,255,410	-	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

See accompanying accountants' report and selected information.



**KLEENAIR SYSTEMS, INC.**  
(A Development Stage Enterprise)  
**SELECTED INFORMATION FOR CONSOLIDATED FINANCIAL STATEMENTS**  
September 30, 2002  
(Unaudited)

**NOTE 1: BASIS OF PRESENTATION**

The accompanying unaudited consolidated 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, 2001. 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 condensed financial statements included in Item 1 of Part 1. Operating results for the nine-month period ended September 30, 2002, are not necessarily indicative of the results that may be expected for the year ending December 31, 2002.

**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 nine months of 2002 and 2001 was \$23,652 and \$11,367, respectively.

Office furniture and equipment	\$ 60,421
Test vehicle	19,787
Analysis equipment	163,020
Leasehold improvements	<u>11,682</u>
	254,910
Accumulated depreciation	<u>(54,719)</u>
Net property & equipment	<u>\$ 200,191</u>

**NOTE 3: PREPAID EXPENSES AND AMORTIZATION**

The Company frequently prepaids 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. During the current periods presented, these amortization costs have been included in advertising and promotion, although this is not necessarily true for the cumulative amounts presented. Amortization totaled \$141,750 and \$198,125 in the nine months ended September 30, 2002 and 2001, respectively.

**NOTE 4: STOCK TRANSACTIONS**

During the first quarter of 2002, the Company issued a total of 10,895 restricted shares valued at \$8,269 for research and development services and sales promotion. Consultants were issued 20,000 unrestricted S-8 shares valued at \$22,350 for business promotion and 3,000 shares valued at \$3,413 for research and development efforts. The Company also sold 1,000,000 shares for \$900,000 pursuant to a private placement.

During the second quarter of 2002, the Company issued a total of 5,849 restricted shares valued at \$3,111 for sales promotion. Unrestricted S-8 shares were issued as follows: 3,000 shares valued at \$2,543 for research and development, 115,000 shares valued at \$104,813 for management consulting, 35,341 shares valued at \$38,200 for sales compensation, and 20,000 shares valued at \$22,200 for acquisition legal services. The Company also

issued 833,250 restricted shares to the stockholders of Carbon Cloth Technologies, Inc. for the acquisition of that entity. (This is described further below.)

During the third quarter of 2002, the Company has issued a total of 109,299 restricted shares valued at \$38,500 for research and development services and sales promotion. Consultants were issued 96,117 unrestricted S-8 shares valued at \$43,988 for business and sales promotion, 50,000 shares valued at \$16,250 for legal services, and 3,000 shares valued at \$1,463 for research and development efforts. The Company also sold 1,454,545 shares for \$750,000 pursuant to a private placement.

#### **NOTE 5: RECEIVABLES**

During the first quarter of 2002, the Company loaned \$120,000 to a licensee. This loan is secured by 100,000 shares of the Company's stock and is expected to be satisfied before the end of the year. During the third quarter, the Company agreed to loan this entity another \$100,000 secured by 120,000 shares of the Company's stock. Only \$30,000 of this was funded during September 2002, with the balance being funded during October 2002.

During the second quarter, the Company advanced \$30,000 to its affiliate in England, NoxMaster Ltd. A consultant has been advanced \$6,000 during the second and third quarters.

An employee of Carbon Cloth has been advanced \$40,000 against stock compensation that he is to receive under an employment agreement entered into in conjunction with the acquisition of that entity.

#### **NOTE 6: ACQUISITION OF CARBON CLOTH TECHNOLOGIES, INC.**

Effective April 30, 2002, the Company acquired Carbon Cloth Technologies, Inc. ("CCT"), a California corporation. CCT is a manufacturer of automotive thermal management systems. Its CarbonGuard™ product is currently installed on a number of New York City Transit Authority buses as enhancements for the operating efficiency of particulate traps. It is expected that this product will generate meaningful revenues during the balance of this year and make a significant contribution toward the Company's overhead expense. It is also expected that there will be a synergy of sales from the combination of presentations for the Company's emission control device and CCT's products.

The Company issued 833,250 restricted shares for this acquisition. A portion of the acquisition agreement calls for the issuance of an additional 166,750 shares pursuant to an employment agreement. These additional shares are compensation and are contingent upon the achievement of certain sales levels.

The Company's acquisition resulted in the addition of the following balance sheet elements as of April 30, 2002:

Accounts receivable	\$ 22,397
Inventory	10,331
Fixed assets (net)	1,392
Accounts payable	(96,144)
Patent license	1,295,234

#### **Pro Forma Financial Information Based on Historical Financial Statements**

The following tables set forth summarized historical financial statements as for the Company and for Carbon Cloth Technologies, adjustments to reflect the effects of the acquisition, and pro form combined amounts. Pro forma adjustments reflect the acquisition of Carbon Cloth.

The balance sheets for the entities are as of March 31, 2002 for KleenAir Systems and April 30, 2002 for Carbon Cloth. The historical income statements are for the year ended December 31, 2001 for KleenAir and for the fiscal year ended September 30, 2001 for Carbon Cloth. The historical income statements for the most recent quarter present the period from January 1 through March 31, 2001 for both entities. Any effects due to the disparity in the dates of the balances sheets presented is believed to be immaterial. No significant transactions occurred during April 2002 for either entity.

Pro Forma Balance Sheets  
As of March 31 and April 30, 2002

	Historical			
	KleenAir	Carbon Cloth	Pro Forma	Pro Forma
	March 31,	April 30,	Adjustments	Combined
	2002	2002		
<b>ASSETS</b>				
Cash	\$ 624,092	\$ (4,720)	\$ -	\$ 619,372
Accounts receivable	1,600	22,397	-	23,997
Inventory	-	10,331	-	10,331
Note receivable	120,000	-	-	120,000
Prepaid expenses	139,714	-	-	139,714
Property & equipment	96,441	4,209	-	100,650
Accumulated depreciation	(32,442)	(2,817)	-	(35,259)
Patent license	161,858	-	1,000,000	1,161,858
Other assets	-	322	-	322
<b>TOTAL ASSETS</b>	<b>\$ 1,111,263</b>	<b>\$ 29,722</b>	<b>\$ 1,000,000</b>	<b>\$ 2,140,985</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>				
<b>CURRENT LIABILITIES:</b>				
Accounts payable	\$ 36,382	\$ 176,489	\$ -	\$ 212,871
Other liabilities	-	40,000	-	40,000
Related party liabilities	167,465	51,329	-	218,794
Total Current Liabilities	203,847	267,818	-	471,665
<b>STOCKHOLDERS' EQUITY:</b>				
Common stock	16,425	511,400	(510,400)	17,425
Other stockholders' equity	4,789,662	-	760,904	5,550,566
Retained earnings	(3,898,671)	(749,496)	749,496	(3,898,671)
Total Stockholders' Equity	907,416	(238,096)	1,000,000	1,669,320
<b>TOTAL LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>	<b>\$ 1,111,263</b>	<b>\$ 29,722</b>	<b>\$ 1,000,000</b>	<b>\$ 2,140,985</b>

Pro Forma Income Statements  
For the Years Ended December 31, 2001 and September 30, 2001

	Historical			
	KleenAir	Carbon Cloth	Pro Forma	Pro Forma
	December	September	Adjustments	Combined
	31, 2001	30, 2001		
Net sales & revenue	\$ 123,788	\$ 49,719	\$ -	\$ 173,507
Cost of goods sold	-	21,286	-	21,286
Research & development costs	241,904	-	-	241,904
Gross profit	(118,116)	28,433	-	(89,683)
Selling, general & administrative expenses	505,766	221,712	100,000	827,478
Income/(loss) from operations	(623,882)	(193,279)	(100,000)	(917,161)
Other income/(expense)	71	-	-	71
Income/(loss) before income taxes	(623,811)	(193,279)	(100,000)	(917,090)
Income tax expense/(benefit)	-	-	-	-
Net income/loss	\$ (623,811)	\$ (193,279)	\$ (100,000)	\$ (917,090)
Earnings per share:				
Basic and diluted	\$ (0.05)	\$ (0.03)		\$ (0.06)
Weighted average shares outstanding:				
Basic and Diluted	13,372,112	5,811,000		14,372,112

**NOTE 7: SETTLEMENT WITH LICENSEE**

During September 2002, the Company entered into a agreement with Extengine Transport Systems, LLC and Ecologic LLC restating and reaffirming certain matters with respect to the license agreements between the Company and these entities and the relationship between the two entities. In this agreement, the Company received an option to reacquire 990,000 shares of the Company held by these entities, agreed to loan \$100,000 to them, and granted them a warrant to purchase additional shares over an 18-month period. The Company's option has an exercise price of \$0.625 per share and expires in January 2003. The loan, along with a previous loan of \$120,000 is to mature in March 2003 and these loans are secured by a total of 310,000 shares of the Company. The warrant granted is for 240,000 shares at an exercise price of \$0.625 per share. The parties also agreed to arbitration regarding a dispute which has arisen regarding certain marketing licenses which were transferred by the Company.

**NOTE 8: SUBSEQUENT EVENTS**

On October 15, 2002, the Company entered into a stock purchase agreement to acquire 51% of the outstanding stock of Servotech Industries, Inc. and Servotech Engineering, Inc. (jointly, Servotech). This agreement includes an option to purchase the remaining interest in the future. Servotech is based Detroit, Michigan and provides services in research, development, and testing of automotive emissions control for various well-known manufacturers of diesel and gasoline engines. Servotech also manufactures specialty engineering parts and develops automotive electronics and software products. Servotech employs 60 people in its research and engineering activities.

This acquisition was reported on a Form 8-K dated October 15, 2002. Financial information required for such acquisitions is expected to be filed within the time period required by the Form 8-K instructions.

## **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 US Patent # 5,224,346 Engine NOx Reduction System issued in 1993, US 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, US 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 and in addition has applied for a patent on a new emission control device, the Sonic Flow Carburetor, which atomizes fuel on gasoline powered engines, enhancing operating efficiency and reducing emissions. A license for this technology has been sold to Ecologic, LLC for China, India and California.

The Company has recently leased new 10,000 square foot R & D facilities at 1711 Langley, Irvine, CA 92614. The Company has also acquired 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 is moving through the final phase of its London Taxi Program funded by a UK government grant. This in-service test involving several London taxicabs started in January 2002. Emissions testing at Millbrook Proving grounds have now been completed and results have been forwarded to the Energy Savings Trust. The Company is applying to have its system registered. 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 on these vehicles have been scheduled for February 2003. Patent awards have now been confirmed for several European countries including the UK, Germany, France, Italy, Spain and Sweden, and anticipated soon for Japan, Brazil, and China.

Systems have been ordered by several other London Boroughs and were installed by the end of the 3rd quarter on both refuse collection trucks and buses. In the 4th Quarter it is expected that systems will be installed on buses in Liverpool.

US 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. EO certification for on-road applications is expected shortly.

The Company is preparing to meet CARB and EPA Retrofit Verification requirements for heavy-duty vehicles on both its NOxMaster™ NOx reduction systems. It will also seek 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 has acquired Carbon Cloth Technologies, Inc., of Malibu, California a manufacturer of automotive thermal management systems. Its CarbonGuard™ is currently 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 and included as a specified component in tender under offer for use with close

to 1,000 particulate traps to be installed over the coming months. A further several hundred buses are anticipated to be upgraded with the CarbonGuard™. It is expected that this product will generate meaningful revenues during the balance of this year and make a significant contribution to the Company's overhead expense. Negotiations are being held with a number of automotive OEM manufacturers to incorporate CarbonGuard™ for a variety of thermal management applications.

Carbon Cloth Technologies has applied for patents in automotive thermal management systems. At present, these are used to enhance the effectiveness of particulate filters which 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, 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 years of experience developing thermal solutions for motorsports industry leaders such as Ferrari, Mercedes-Benz and Penske, which has enabled development of the CarbonGuard™, a significant addition to the battle on pollution.

A definitive agreement was signed for the acquisition of 51% of ServoTech Industries, Inc, a Ford tier one supplier in Detroit that is expected to be closed at the end of the 4th quarter of 2002. This company employs over 50 people, has revenues approaching \$7 million and EBITDA of over \$1 million. 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 US and Europe.

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.

## **PART II - OTHER INFORMATION**

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

Exhibit 23 --- Accountants' consent to incorporation by reference.

Exhibit 99 --- Certification of CEO and CFO Pursuant to 18 U.S.C. § 1350, as Adopted Pursuant to § 906 of the Sarbanes-Oxley Act of 2002.

Reports on Form 8-K ---

A Form 8-K dated September 13, 2002 reported that the Registrant had entered into an agreement with Extengine Transport Systems, LLC, Ecologic, LLC, and Phillip K. Roberts restating and reaffirming certain matters with respect to their relationship and licensing agreements.

A Form 8-K dated October 15, 2002 reported that the Registrant had completed negotiations and signed an agreement to acquire 51% of the outstanding stock of Servotech Industries, Inc. and Servotech Engineering, Inc.

**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, 2002

/s/ LIONEL SIMONS  
By: Lionel Simons, President,  
Secretary, Principal Accounting Officer, &  
Principal Financial Officer