

Ethos Environmental, Inc.
Form 10-Q
August 14, 2008

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

FORM 10 – Q

[mark one]

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

For the quarterly period ended: June 30, 2008

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

For the transition period from _____ to _____

Commission File Number: 000-26673

ETHOS ENVIRONMENTAL, INC.
(Name of Small Business Issuer in Its Charter)

Nevada
(State or Other Jurisdiction
of Incorporation or Organization)

88-0467241
IRS Employer
Identification Number

6800 Gateway Park
San Diego, CA 92154
(619) 575-6800

(Address and Telephone Number of Principal Executive Offices)

Securities registered under Section 12(b) of the Exchange Act:

Title of each class registered:
None

Name of each exchange on which registered:
Over-the-Counter Bulletin Board

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, par value \$0.0001
(Title of class)

with a copy to:
SteadyLaw Group, LLP
501 W. Broadway, Suite 800

Edgar Filing: Ethos Environmental, Inc. - Form 10-Q

San Diego, CA 92101
Telephone (619) 399-3090
Telecopier (619) 330-1888

Table of Contents

1

Edgar Filing: Ethos Environmental, Inc. - Form 10-Q

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

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

Table of Contents

2

Edgar Filing: Ethos Environmental, Inc. - Form 10-Q

Large accelerated filer ☐

Accelerated filer ☐

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

Smaller reporting company ☒

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

The registrant has 39,520,174 shares of common stock outstanding as of August 14, 2008.

Table of Contents

3

Quarterly Report on FORM 10-Q

For The Period Ended
June 30, 2008

Table of Contents

Ethos Environmental, Inc.		
PART I - FINANCIAL INFORMATION		Page No.
<u>ITEM 1.</u>	FINANCIAL STATEMENTS CONSOLIDATED BALANCE SHEETS CONSOLIDATED STATEMENTS OF OPERATIONS CONSOLIDATED STATEMENTS OF CASH FLOWS NOTES TO CONSOLIDATED FINANCIAL STATEMENTS	5
<u>ITEM 2.</u>	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	14
<u>ITEM 4T.</u>	CONTROLS AND PROCEDURES	35
PART II - OTHER INFORMATION		
<u>ITEM 1.</u>	LEGAL PROCEEDINGS	36
<u>ITEM 1A.</u>	RISK FACTORS	36
<u>ITEM 2.</u>	UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	36
<u>ITEM 3.</u>	DEFAULTS UPON SENIOR SECURITIES	37
<u>ITEM 4.</u>	SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS	37
<u>ITEM 5.</u>	OTHER INFORMATION	37
<u>ITEM 6.</u>	EXHIBITS	37
<u>SIGNATURES</u>		38

Table of Contents

PART I.

Item 1. FINANCIAL STATEMENTS

ETHOS ENVIRONMENTAL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	June 30, 2008	December 31, 2007
Assets		
Current Assets:		
Cash and cash equivalents	\$ 133,971	\$ 74,176
Accounts receivable-trade, net	7,147,495	5,951,275
Inventory, net	1,128,335	1,376,030
Other current assets	5,000	-
Total Current Assets	8,414,801	7,401,481
Property and Equipment, net	217,354	228,452
Other Assets	705,419	699,419
Total Assets	\$ 9,337,574	\$ 8,329,352
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current Liabilities:		
Accounts payable	\$ 141,727	\$ 223,891
Accrued liabilities	309,221	109,300
Notes payable	1,300,000	350,000
Notes payable-related party	195,997	246,521
Total Current Liabilities	1,946,945	929,712
Commitments:	-	-
Stockholders' Equity (Deficit):		
Common stock, \$.0001 par value 100,000,000 authorized		
39,450,243 issued and outstanding	3,945	3,687
Additional Paid in Capital	37,496,371	35,615,040
Accumulated deficit	(30,109,687)	(28,219,087)
Total Stockholders' Equity (Deficit)	7,390,629	7,399,640
Total Liabilities and Stockholders' Equity (Deficit)	\$ 9,337,574	\$ 8,329,352

See notes to consolidated financial statements.

Table of Contents

ETHOS ENVIRONMENTAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Revenues	\$ 1,286,884	\$ 2,599,962	\$ 2,391,352	\$ 5,297,095
Cost of Goods Sold	404,424	785,297	751,613	1,709,941
Gross Profit	882,460	1,814,665	1,639,739	3,587,154
Operating Expenses				
Depreciation (Other than Cost of Goods Sold)	2,134	5,280	4,273	10,273
Selling Expenses	85,420	200,226	173,430	328,929
General and Administrative	2,061,269	2,053,897	3,236,696	4,570,510
Debt Extinguishment		6,646,171	-	6,646,171
Total Operating Expenses	2,148,823	8,905,574	3,414,399	11,555,883
Loss from operations	(1,266,363)	(7,090,909)	(1,774,660)	(7,968,729)
Other Income (Expense)				
Other income (loss)	-	35	2,500	35
Gain on Sale of Assets	-	47,929	-	179,003
Interest expense	(38,000)	(200,632)	(118,440)	(378,292)
	(38,000)	(152,668)	(115,940)	(199,254)
Income (loss) before provision for income taxes	(1,304,363)	(7,243,577)	(1,890,600)	(8,167,983)
Provision for income taxes	-	-	-	-
Net Income (Loss)	\$ (1,304,363)	\$ (7,243,577)	\$ (1,890,600)	\$ (8,167,983)
Basic and Diluted (Loss) per Common Share	\$ (0.03)	\$ (0.30)	\$ (0.05)	\$ (0.35)
Basic and Diluted Weighted Average Shares Outstanding	38,747,181	23,763,000	37,925,961	23,570,744

See notes to consolidated financial statements

Table of Contents

ETHOS ENVIRONMENTAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock Shares	Amount	Paid in Capital	Accumulated Deficit	Total Stockholders' Equity
Balance, December 31, 2006	23,107,687	\$ 2,311	\$ 11,560,535	\$ (9,866,577)	\$ 1,696,269
Common stock issued for cash	2,500,000	250	2,049,750	-	2,050,000
Common stock cancelled	(50,000)	(5)	5	-	-
Warrants issued for extinguishment of debt			6,646,171	-	6,646,171
Common stock issued for services	11,314,000	1,131	15,358,579	-	15,359,710
Net loss	-	-	-	(18,352,510)	(18,352,510)
Balance, December 31, 2007	36,871,687	3,687	35,615,040	(28,219,087)	7,399,640
Common stock issued for services and expense	2,578,556	258	1,881,331	-	1,881,589
Net Loss	-	-	-	(1,890,600)	(1,890,600)
Balance, June 30, 2008	39,450,243	\$ 3,945	\$ 37,496,371	\$ (30,109,687)	\$ 7,390,629

See notes to consolidated financial statements

[Table of Contents](#)

ETHOS ENVIRONMENTAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Six Months Ended June 30,	
	2007	2006
Operating Activities:		
Net income (loss)	\$ (1,890,600)	\$ (8,167,983)
Adjustments to reconcile net income (loss) to net cash Provided (used) by operating activities:	-	-
Gain on sale of assets	-	(179,003)
Depreciation	42,734	126,987
Common stock issued for services and expenses	1,881,589	3,875,710
Loss on Debt Extinguishment	-	6,646,171
Changes in Assets and Liabilities:		
Accounts receivable	(1,196,220)	(3,627,776)
Inventory	247,695	87,506
Other current assets	(5,000)	(394,419)
Other assets	(6,000)	-
Accounts payable	(82,164)	286,454
Accrued liabilities	199,921	-
Net Cash Provided (Used) by Operating Activities	(808,045)	(1,346,353)
Investing Activities		
Purchase of Property and Equipment	(31,636)	(190,983)
Net Cash Used by Investing Activities	(31,636)	(190,983)
Financing Activities:		
Proceeds from Sale/Leaseback	-	737,968
Proceeds from Note Receivable	-	(23,100)
Proceeds from Note Payable	1,300,000	705,334
Repayment of Notes Payable	(350,000)	-
Repayment of Notes Payable-Related Party	(50,524)	65,124
Net Cash Provided by Financing Activities	899,476	1,485,326
	-	-
Net Increase in Cash	59,795	(52,010)
Cash at Beginning of Year	74,176	64,867
Cash at End of Year	\$ 133,971	\$ 12,857
Supplemental Disclosures:		
Cash paid for income taxes	\$ -	\$ -
Cash paid for interest	\$ -	\$ -

Non Cash Transactions: \$ - \$ -

Table of Contents

8

ETHOS ENVIRONMENTAL, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Organization and Significant Accounting Policies

Organization

Ethos Environmental, Inc. ("the Company") manufactures and distributes fuel reformulating products that increase fuel mileage, reduce emissions, and maintain lower fuel costs. The Company is based in Southern California and sells its product, primarily in the United States, Latin America, Europe, Africa, Australia and Asia.

Acquisition

On April 20, 2006, Victor Industries, Inc. ("Victor"), with the approval of its Board of Directors, executed an Agreement and Plan of Merger with San Diego, CA based Ethos Environmental, Inc., a Nevada corporation.

At a meeting of shareholders of the Company held on October 30, 2006, a majority of shareholders voted in favor of the merger. On November 2, 2006, the merger was consummated. As part of the merger, Victor redomiciled to Nevada, and changed its name to Ethos Environmental, Inc. In addition thereto, and as part of the merger, Victor set a record date of November 16, 2006 for a reverse stock split of 1 for 1,200 of the issued and outstanding shares of Victor. Prior to the reverse stock split and subsequent merger, Victor issued 47,685,805 shares to reduce its liabilities by \$257,503 based on the pre-merger stock price of \$0.0054 per share. All of the per share data in these consolidated financial statements are presented on a post-split basis.

The merger provides for a business combination transaction by means of a merger of Ethos with and into Victor, with Victor as the corporation surviving the merger. Under the terms of the merger, Victor acquired all issued and outstanding shares of Ethos in exchange for 17,718,187 shares of common stock of Victor. Shares of Victor common stock, representing an estimated 97% of the total issued and outstanding shares of Victor common stock, were issued to the Ethos stockholders. Ethos shareholders were able to exchange their shares beginning on or after November 16, 2006, the record date set for the reverse stock split.

The merger was intended to qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code and no gain or loss was recognized by Victor as a result of the merger.

The merger is accounted for under the purchase method of accounting as a reverse acquisition in accordance with U.S. generally accepted accounting principles for accounting and financial reporting purposes. Under this method of accounting, Ethos is treated as the "accounting acquirer" for financial reporting purposes. Accordingly the operations of the company are included in these financial statements as of November 2, 2006. In accordance with guidance applicable to these circumstances, the merger was considered to be a capital transaction in substance. Accordingly, for accounting purposes, the merger was treated as a recapitalization of Victor. The assets and liabilities of Victor have been included in these consolidated financial statements at their net book value.

The assets acquired and liabilities assumed of Victor were as follows:

Assets	66,062
Liabilities	62,931
Net	
Recapitalization	3,131

Table of Contents

The accounting effect of the reverse acquisition is reflected in the consolidated statements of stockholders' equity.

The historical financial statements prior to the reverse merger transaction have been restated to be those of the accounting acquirer and historical stockholders' equity prior to the reverse merger has been retroactively restated for the equivalent number of shares received in the merger after giving effect to the difference in par value of the issuer's and acquirer's stock with an offset to additional paid-in capital.

As part of the reverse acquisition, the prior activities of the Company were discontinued. No discontinued operations are presented in these financial statements since there were no expenses or revenues incurred after November 2, 2006 related to these operations.

The Company agreed to acquire Ethos Environmental, Inc. because of its anticipated future growth in a marketplace that is in strong demand for its product, and it was believed that the acquisition would benefit the existing shareholders of both companies.

Of the 4,910,000 shares issued in 2006, 3,600,000 shares represented a pre-merger commitment by the entity then known as Ethos Environmental, Inc. The entity then known as Ethos Environmental, Inc. committed to issue the shares on October 15, 2006, and the shares were to be issued regardless of the outcome of the then pending merger as such shares were not for services in any way associated with the then pending merger. As such, the shares were valued at fair value as determined by the pre-merger Ethos Board of Directors.

On the date that the pre-merger Ethos Environmental, Inc. committed to issue the shares, there was not a public market for Ethos' common stock, and the most readily determinable value of the stock was fair value. Of the 3,600,000 shares, 100,000 were issued for services rendered by an outside consultant prior to, and unrelated to, the merger. As this was the number of shares that said consultant was willing to accept as payment for services rendered valued at \$25,000, we believe that the value of \$0.25 approximated the fair value of the shares on the date of the commitment and therefore was the appropriate value to be used.

The remaining 3,500,000 shares (the "Bonus Shares") were issued to our Chief Executive Officer as a one-time bonus by the pre-merger entity known as Ethos Environmental, Inc. The Bonus Shares were not subject to any performance and/or service conditions, and there was no pre-existing arrangement or agreement regarding the Bonus Shares.

Since the 3,600,000 shares were due and payable in the 4th quarter of 2006 by the pre merger Ethos, these shares have been recorded on the year end financial statements of the post-merger entity. All 3,600,000 shares were deemed fully paid and non-assessable as of the date authorized by the pre-merger Ethos Board of Directors, October 15, 2006.

The 3,600,000 shares were accounted for at the fair value of \$0.25 and charged against general and administrative expenses in accordance with Generally Accepted Accounting Principles (GAAP). The remaining 1,310,000 shares were issued in compliance with prior consulting agreements and valued at the market price at the date of issue, \$5.10. The value of these shares was charged against selling expenses and general and administrative expenses. There was no cash involved in these transactions.

Going Concern

The Company has incurred significant losses from operations in the last two years. The Company's ability to continue as a going concern is in substantial doubt and is dependent upon obtaining additional financing and/or achieving a sustainable profitable level of operations.

Table of Contents

Management of the Company has undertaken steps as part of a plan with the goal of sustaining the Company operations for the next twelve months and beyond. These steps include: (a) attempting to raise additional capital and/or other forms of financing; (b) controlling overhead and operating expenses; and (c) continuing to increase the sales of its fuel reformulating product. There can be no assurance that any of these efforts will be successful.

Principles of Consolidation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiary. All material inter-company accounts have been eliminated in consolidation.

Interim Disclosure

The interim period consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the "SEC"). Certain information and footnote disclosure normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such SEC rules and regulations. The interim period consolidated financial statements should be read together with the audited consolidated financial statements and accompanying notes for the year ended December 31, 2007, included in the Company's annual report on Form 10-KSB. In the opinion of the Company, the unaudited consolidated financial statements contained herein contain all adjustments necessary (consisting of a normal recurring nature) to present a fair statement of the results of the interim periods presented.

The results of operations for the three months ended June 30, 2008, are not necessarily indicative of the results to be expected for the entire year ending December 31, 2008.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from the estimated amounts.

Cash

Cash includes a payroll account and an operating checking account held at a financial institution. The Company's cash balances exceed federally insured limits from time to time.

Accounts Receivable

Accounts receivable are stated at their principal balances, do not bear interest and are generally unsecured. Management considers all balances over 30 days old to be past due. However, if credit is extended management conducts a periodic review of the collectability of its accounts receivable. If an account is determined to be uncollectible based on historical experience and the current economic climate, an allowance is established and the account is written off against the allowance. The Company determined that an allowance of \$111,362 at June 30, 2008 was necessary. At June 30, 2008, 71% of accounts receivable is due from one Latin American customer, and 19% are due from one U.S. customer.

Inventory

Inventory consists primarily of the Company's fuel reformulating product and is stated at the lower of cost or market. At June 30, 2008, inventory consisted of \$56,368 in finished goods and \$1,071,967 in raw materials.

Table of Contents

11

Property and Equipment

Property and equipment are recorded at cost. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the shorter of the anticipated lease term or the estimated useful life. The Company's policy is to capitalize items with a cost greater than \$4,000 and an estimated useful life greater than one year. The Company reviews all property and equipment for impairment at least annually.

Fair Value of Financial Instruments

The carrying value of the Company's accounts receivable, accounts payable, accrued expenses, note payable, and note payable related party approximate their estimated fair value due to the relatively short maturities of those instruments.

Revenue Recognition

Revenue from the sale of fuel reformulating products is recorded when the product is shipped, the price is fixed and determinable, collection is reasonably assured, and no further obligations of the Company remain.

Stock Based Compensation

The Company accounts for stock based awards in accordance with SFAS No. 123(R) "share-based payment", which requires measurement of compensation cost for all stock-based awards at fair value on the date of grant and recognition of compensation over the service period for awards expected to vest. The fair value of stock options is determined using the Black-Scholes valuation model, which is consistent with the Company's valuation techniques previously utilized for options in footnote disclosures required under SFAS No. 123, "Accounting for Stock Based Compensation", as amended by SFAS No. 148, "Accounting for Stock Based Compensation Transition and Disclosure".

Since the Company did not issue stock options to employees during the year ended December 31, 2007 or 2006, nor during the six months ended June 30, 2008, there is no effect on net loss or earnings per share had the Company applied the fair value recognition provisions of SFAS No. 123(R) to stock-based employee compensation. When the Company issues shares of common stock to employees and others, the shares of common stock are valued based on the market price at the date the shares of common stock are approved for issuance.

Earnings Per Share

Basic earnings per share is computed by dividing the net income available to common shareholders by the weighted average number of common shares outstanding in the period. Diluted earnings per share takes into consideration common shares outstanding (computed under basic earnings per share) and potentially dilutive common shares. There were 2,900,000 dilutive securities outstanding at June 30, 2008 and at June 30, 2007. The convertible feature of the Notes Payable is not included in the calculation of diluted earnings per share since it would not have an appreciable effect on the earnings per share.

Common Stock

During the three month period ended June 30, 2008, the Company issued 1,896,106 shares of stock for the payment of expenses valued at \$1,175,201, and 206,578 shares of stock for services, valued at \$87,515.

Table of Contents

Note 2. New Accounting Pronouncements

In May 2008, the FASB issued SFAS No. 163, “Accounting for Financial Guarantee Insurance Contracts—an interpretation of FASB Statement No. 60”. This statement refers to insurance enterprises and it is not anticipated that this statement will have an effect on the current method of reporting for the Company.

In May 2008, the FASB issued SFAS No. 162, “The Hierarchy of Generally Accepted Accounting Principles”. This Statement identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States (the GAAP hierarchy). It is not anticipated that this statement will have an effect on the current method of reporting for the Company.

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No.133”. The Statement requires that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. The statement is effective for interim periods beginning after November 15, 2008 although early adoption is encouraged. The Company has not determined the impact this standard will have on its consolidated operating results or financial position upon adoption.

In December 2007, the FASB issued SFAS No. 141R, “Business Combinations”. This statement is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company has not determined the impact this standard will have on its consolidated operating results or financial position upon adoption.

In December 2007, the FASB issued SFAS No. 160, “Non-controlling Interests in Consolidated Financial Statements—an amendment of ARB No. 51”. This statement addresses the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated statement of financial position within equity, but separate from the parent’s equity. The statement is effective as of the beginning of an entity’s first fiscal year that begins after December 15, 2008. The Company has not determined the impact this standard will have on its consolidated operating results or financial position upon adoption.

Note 3. Subsequent Events

On March 26, 2008, the Company issued a Secured Promissory Note in exchange for an aggregate amount of \$1,000,000 cash investment received on January 1, 2008. The note matured and became due on July 30, 2008, as of the date of this report the Company has repaid and satisfied the Note in full. In order to do so, the Company received a Nonrecourse Loan in the amount of \$500,000 from its Chief Executive Officer in order to satisfy the amount due and owing under the note.

On August 11, 2008, the Company entered into a Stock Purchase Agreement and a Note and Warrant Purchase Agreement with MKM Opportunity Master Fund, Limited, a Cayman Islands corporation a non-affiliated investors pursuant to which, in exchange for an aggregate payment of \$600,000 in cash (the “Financing Transaction”). Pursuant to the terms of the Stock Purchase Agreement the Company sold 909,091 shares of the Company’s Common Stock for an aggregate purchase price of \$300,000. In connection with the sales of Common Stock pursuant to the Stock Purchase Agreement, the Company entered into a Securities Purchase Agreement with Buyer whereby the Company sold one Unit in the aggregate principal amount of \$300,000. The Unit included a convertible promissory note and a warrants to purchase in the aggregate 1,000,000 shares of the Company’s common stock at an exercise price of \$0.25 per share.

Subsequent to the quarter ended June 30, 2008, there were no shares issued for expenses and 69,931 shares were issued for services.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS AND PLAN OF OPERATION

This discussion and analysis should be read in conjunction with the accompanying Financial Statements and related notes. Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of any contingent liabilities at the financial statement date and reported amounts of revenue and expenses during the reporting period. On an on-going basis we review our estimates and assumptions. Our estimates are based on our historical experience and other assumptions that we believe to be reasonable under the circumstances. Actual results are likely to differ from those estimates under different assumptions or conditions, but we do not believe such differences will materially affect our financial position or results of operations. Our critical accounting policies, the policies we believe are most important to the presentation of our financial statements and require the most difficult, subjective and complex judgments, are outlined below in "Critical Accounting Policies," and have not changed significantly.

In addition, certain statements made in this report may constitute "forward-looking statements". These forward-looking statements involve known or unknown risks, uncertainties and other factors that may cause the actual results, performance, or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Specifically, 1) our ability to obtain necessary regulatory approvals for our products; and 2) our ability to increase revenues and operating income, is dependent upon our ability to develop and sell our products, general economic conditions, and other factors. You can identify forward-looking statements by terminology such as "may," "will," "should," "expects," "intends," "plans," "anticipates," "believes," "estimates," "predicts," "potential," "continues" or the negative of these terms or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements.

Overview

The mission of Ethos Environmental is to be recognized as the industry standard for high quality, non-toxic cleaning and lubricating products that increase fuel mileage and reduce these ecologically damaging emissions from vehicles, and at a price everyone can afford. The goal of the company is to make the world a better place, "one gallon at a time". According to the Environmental Protection Agency (EPA), "The burning of fuels releases carbon dioxide (CO₂) into the atmosphere and contributes to climate change [Global Warming], but these emissions can be reduced by improving your car's fuel efficiency." Air pollution caused by cars, trucks and other vehicles burning petroleum-based fuels is one of the most harmful and ubiquitous environmental problems. Furthermore, local accumulation in heavy traffic is the greatest source of community ambient exposure, largely because carbon monoxide is formed by incomplete combustion of carbon containing fuels.

Ethos Environmental manufactures and distributes a unique line of fuel reformulators that contain a blend of low and high molecular weight esters. The product adds cleaning and lubrication qualities to any type of fuel or motor oil. The overall benefits are increased fuel mileage, reduced emissions and reduced maintenance costs as the product allows engines to perform cooler, smoother and with more vigor.

Esters

In the simplest terms, esters can be defined as the reaction products of acids and alcohols. Thousands of different kinds of esters are commercially produced for a broad range of applications. Within the realm of synthetic lubrication, a relatively small substantial family of esters have been found to be very useful in severe environment applications.

Esters lubricants have already captured certain niches in the industrial market such as reciprocating air compressors and high temperature industrial oven chain lubricants. When one focuses on high temperature extremes and their telltale signs such as smoking, wear, and deposits, the potential applications for the problem solving ester lubricants are virtually endless.

In many ways esters are very similar to the more commonly known and used synthetic hydrocarbons or PAOs. Like PAOs, esters are synthesized from relatively pure and simple starting materials to produce predetermined molecular structures designed specifically for high performance lubrication. Both types of synthetic base stocks are primarily branched hydrocarbons which are thermally and oxidatively stable, have high viscosity indices, and lack the undesirable and unstable impurities found in conventional petroleum based oils. The primary structural difference between esters and PAOs is the presence of multiple ester linkages (COOR) in esters which impart polarity to the molecules. This polarity affects the way esters behave as lubricants in the following ways:

Table of Contents

14

Edgar Filing: Ethos Environmental, Inc. - Form 10-Q

Volatility: The polarity of the ester molecules causes them to be attracted to one another and this intermolecular attraction requires more energy (heat) for the esters to transfer from a liquid to a gaseous state. Therefore, at a given molecular weight or viscosity, the esters will exhibit a lower vapor pressure which translates into a higher flash point and a lower rate of evaporation for the lubricant. Generally speaking, the more ester linkages in a specific ester the higher its flash point and the lower its volatility.

Lubricity: Polarity also causes the ester molecules to be attracted to positively charged metal surfaces. As a result, the molecules tend to line up on the metal surface creating a film which requires additional energy (load) to penetrate. The result is a stronger film which translates into higher lubricity and lower energy consumption on lubricant applications.

Detergency/Dispersency: The polar nature of esters also makes them good solvents and dispersants. This allows the esters to solubilize or disperse oil degradation by-products which might otherwise be deposited as varnish or sludge, and translates into cleaner operation and improved additive solubility in the final lubricant.

Biodegradability: While stable against oxidative and thermal breakdown, the ester linkage provides a vulnerable site for microbes to begin their work of biodegrading the ester molecule. This translates into very high biodegradability rates for ester lubricants and allows more environmentally friendly products to be formulated.

Ethos Environmental manufactures and distributes Ethos FR, a unique combination of high-quality, non-toxic, specially designed esters that uses only the elements of carbon, hydrogen and oxygen. It significantly reduces emissions, fuel consumption, and engine maintenance costs. Ethos FR provides an immediate, cost-effective strategy for fighting air pollution caused by fossil fuels and the internal combustion engine. This combination of low molecular cleaning esters and the high molecular lubricating esters, reformulates any fuel whether it's gasoline, diesel, methanol, ethanol, LNG, compressed natural gas or bio-diesel. When blended with fuels, Ethos FR reduces the emissions of hydrocarbons (HC), nitrogen oxides (NOx), carbon monoxide (CO), particulate matter (PM) and other harmful products of combustion. Yet, the emission of O₂ is significantly increased. An EPA registered laboratory, confirms that Ethos FR is 99.99976% clean upon ignition and cashless upon combustion. Ethos FR is free of carcinogens.

Ethos FR is a light colored, multi-functional fuel reformulator. It is designed for use in all fuels to increase power and mileage, dissolve gums and varnishes, lubricate upper cylinder components and keep the entire fuel system clean and highly lubricated. It is recommended for use at 1 part in 1280, which is equal to 1 fluid ounce of Ethos FR per 10 gallons of fuel.

Typical Specifications	
Tests	Results
Viscosity @ 37.8° C,CS	10.39
Viscosity @ 100° F, SSU	60.2
S p e c i f i c	
Gravity @0.93 15.6/15.6°C	
A P I	
G r a v i t y ,	26.6
Degrees	
Flash Point,	149° C
C O C , ° C	(300°F)
(°F)	
Color andLight,	
Appearance b r i g h t	

a n d
clear
Sediment None

Ethos Environmental offers a cost-effective solution to relieve skyrocketing fuel prices and help lessen environmental regulatory pressures. Ethos products address one problem that has two side effects, wasted fuel and air pollution. Fuel burns inefficiently in an internal combustion engine and that inefficiency leads to wasted fuel transformed into toxic emissions. Ethos products make fuel burn more efficiently so it significantly improves both of the aforementioned adverse effects. Most important, the use of Ethos results in fuel cost savings to the customer.

Fuel and Maintenance Costs Savings:

- Increases Miles-Per-Gallon between 7% and 19% Fleet-Wide
- Enhances Engine Performance by Reducing Heat Produced by Friction

Table of Contents

15

Fines and Downtime are Reduced Due To Air Pollution:

- Reduces Toxic Emissions By 30% or More
- Free Of Carcinogens
- Non-Toxic & Non-Hazardous
- Not a Petrochemical
- 99.99976% cashless upon Combustion

Repairs:

- Improves Combustion
- Cleans Fuel System
- Lubricates Moving Components
- Extends Engine Life by Reducing Friction

How Do Ethos Products Work?

Ethos products reformulate any fuel, resulting in two important benefits. The first benefit is the added lubricity to the engine. The second is adding cleansing properties to the fuel. All of the internal components benefit from the cleansing and lubricating action including the fuel lines, filters, carburetors, spark plugs and injectors. Ethos also conditions the engine seals, keeping them tighter for a longer period of time. A cleaner, more lubricated engine runs smoother, requires less maintenance and reduces engine heat significantly, thereby returning horsepower closer to the manufacturer's specifications. Ethos removes carbon deposits that cause fuel to combust incompletely, resulting in wasted fuel that creates toxic emissions. The combination of cleaning and lubricating esters in our products stabilize the fuel without changing its specifications.

In Ethos FR®, for example, a group of low molecular weight esters clean the dirty deposits formed by fuels and the combustion process. These deposits lower performance of an engine making it less fuel-efficient. Causing it to exhaust raw fuel, which is the primary contributor to pollution. A group of high molecular weight esters lubricate the engine surfaces as the fuel runs through it. Their molecular structure is small enough to penetrate the metal and form a lubricating layer between surfaces. This process allows the moving components of an engine to operate smoother and with less power-robbing friction and heat.

The primary task for the Company is to distinguish itself as an industry leader in the reduction of fuel costs and emission problems at a profit gain to the commercial user. Part of the challenge before us is to differentiate Ethos products from two types of products in this industry, additives - that are purported to increase fuel mileage and oxygenates - which are mandated to lower emissions. Both additives and oxygenates provide short-term benefits at the price of long-term engine or environmental problems.

Additives contain highly refined petrochemicals or compressed hydrocarbons that promise better fuel mileage and sometimes lower emissions, by "cleaning" the engine. Used mainly by individual consumers, they are expensive and commonly sold at the auto parts and retail stores. More than five thousand EPA-registered fuel additives compete in the retail market and although the EPA requires that such products be registered, that registration constitutes neither endorsement nor validation of the product's claims.

Oxygenates, such as methyl tertiary butyl ether (MTBE) and Ethanol, are intended to lower emissions by adding oxygen to the fuel. Ethos FR® products actually complement federally mandated oxygenates by lowering emissions, but as mentioned earlier, Ethos FR® is not an oxygenate and cannot be used for the purpose of complying with current language federal legislation.

In contrast, Ethos products have cleaning properties that contribute to the lubrication of the engine instead of destroying it. The ester-based formula dissolves the gums and residues and adds important lubrication that an engine needs. The engine stays clean and lubricated, allowing it to run smoothly and efficiently.

Table of Contents

16

Edgar Filing: Ethos Environmental, Inc. - Form 10-Q

Both E85 and biodiesel, such as B5, are alternative measures currently being considered for use by the federal government. However, these alternative measures rely entirely on agricultural resources such as corn, barley, wheat and vegetable oils. Realistically, the agricultural sector of the economy cannot hope to produce sufficient quantities of these products to cause an appreciable effect on global warming. This is a problem not facing Ethos as the product is readily available and continuously produced at a lower price.

While the debate on emissions reduction solutions continues, Ethos Environmental is making a difference in cleaning the air today while reducing fuel costs to its customers. Extensive road tests with Ethos FR® have proven that commercial fleets, on average, increase fuel mileage between 7% and 19% and reduce emissions by more than 30%. Ethos FR® is non-toxic, non-hazardous and works with any fuel used in cars, trucks, buses, RV's, ships, trains and generators.

The overall result is that Ethos FR® makes engines combust fuel more efficiently. When an engine uses each measure of fuel to the maximum degree possible, it has two very important benefits. It reduces fuel consumption and reduces non-combusted residues that an engine expels in the form of exhaust emissions such as hydrocarbons, nitrogen oxides, carbon monoxide, particulate matter and other harmful products of combustion. Unused fuel is saved in the fuel tank, waiting to be used efficiently by the engine, instead of exhausted in the form of toxic emissions. Ethos FR® reduces emissions without adding any of its own components to the exhaust since it is 99.99976% ash-less upon combustion, and free of carcinogenic compounds.

Ethos Environmental is also at the forefront in the development of new blending methods and is positioned to become an industry leader with new products currently under development.

Over the last decade, the unmatched value of Ethos FR® products has been proven through millions of miles of on-the-road testing. On average, customers have achieved a 7% to 19% increase in fuel mileage, and more than a 30% reduction in emissions.

Ethos seeks both a cleaner environment and economic success. As the name Ethos suggests, we are committed to the highest ethical standards - in the product that we sell, in the relationship with our clients, and in the conduct of our business. The Company's approach is to sell Ethos FR® "one gallon at a time", earning the trust and loyalty of each customer by providing products that perform as promised and make a positive difference in the world.

Our Corporate History

We were originally incorporated under the laws of the State of Idaho on January 19, 1926 under the name of Omo Mining and Leasing Corporation. The Company was renamed Omo Mines Corporation on January 19, 1929. The name was changed again on November 14, 1936 to Kaslo Mines Corporation and finally Victor Industries, Inc. on December 24, 1977.

As Victor Industries, Inc., the Company developed, manufactured, and marketed products related to the use of the mineral known as zeolite. Zeolites have the unique distinction of being nature's only negatively charged mineral. Zeolites are useful for metal and toxic chemical absorbents, water softeners, gas absorbents, radiation absorbents and soil and fertilizer amendments.

Reverse Acquisition of Ethos

On November 2, 2006, as part of a two-step reverse merger, the Company merged with and into Victor Nevada, Inc. a newly incorporated entity for the purpose of redomiciling under the laws of the State of Nevada. Concurrently therewith, we completed the merger transaction with Ethos Environmental, Inc., a privately held Nevada corporation "Ethos". The Company was the surviving entity. To more adequately reflect the new direction of the Company, the name was changed to Ethos Environmental, Inc. and the Company adopted the business plan of Ethos.

Products

Ethos manufactures a unique line of fuel reformulators that contain a blend of low and high molecular weight esters. Ethos products add cleaning and lubricating qualities to any type of fuel or motor oil, allowing engines to perform cooler, smoother and with more vigor. The overall benefits are increased fuel mileage, reduced emissions, and reduced maintenance costs.

Table of Contents

17

Ethos fuel reformulating products increase fuel mileage and reduce emissions by burning fuel more completely. Exhaust is essentially unburned fuel, i.e. wasted fuel, so when that fuel is used more completely, the engine delivers better mileage from every tank. Efficient fuel use also improves engine performance due to the fact that a more complete combustion process obtains increased power from every engine revolution.

The management of Ethos Environmental firmly believes that the market for our product is aggressively expanding. Worldwide fuel consumption is approximately 85 million barrels per day and projected by the Energy Information Administration to continue to grow to 97 million barrels per day by 2015, and 118 million barrels per day by 2030. Much of the dramatic growth over the past decade has been fueled by the dramatic expansion of India, China and Brazil. As additional undeveloped countries begin to expand, so too will fuel consumption and the Company's market base. In addition, consumers are becoming more sensitive to increased fuel economy as oil prices have increased eight times since the late 1990s.

Ethos products reduce fuel emissions, benefiting the environment in two notable ways:

1. The use of Ethos products reduce engine exhaust emissions by 30% or more, including measurable reductions in the emission of hydrocarbons (HC), nitrogen oxides (Nox), and carbon monoxide (CO). All of these emissions are highly toxic and detrimental to the environment.
2. Ethos products reduce emissions of particulate matter, especially in diesel-powered engines. Diesel fuel is commonly dirty and maintaining a diesel engine in the prime condition necessary to reduce emissions is both expensive and time-consuming. As a result, diesel engines are a constant source of air contaminants. In most industrialized countries, including the U.S., diesel engines are one of the largest sources of air pollution. When Ethos products are added to diesel fuel, the engine runs cleaner, smoother and cooler - significantly reducing sooty exhaust. Engines treated with Ethos run with less friction, heat and noise. Fuel and lubricating systems, filters, tanks, and injectors last longer, reducing maintenance costs.

Ethos has two products, Ethos FR® and Ethos Bunker Fuel Conditioner ("Ethos BFC"). There are two esters used in each product, a light ester and a heavy ester. For the Ethos FR®, we obtain the esters from major suppliers. The mineral oil used in the Ethos FR® is obtained, primarily, from major suppliers.

Ethos FR® can be used in any fuel. Ethos BFC is used for Bunker Fuel, which is used in external combustion engines.

Ethos products provide risk-free benefits with an economic gain to the client. To date, all customers have testified, either verbally or in writing, that they experienced a monetary gain on fuel savings, with all stating that they experienced an average improvement in mileage per gallon between 7% and 19%, depending on the fuel (gasoline or diesel), the vehicle used, and the individual driver's practices and driving traits.

Trademarks

We own the following trademark(s) used in this document (which is registered with the United States Patent and Trademark Office under Registration Number 3,015,561): Ethos FR®. Trademark rights are perpetual provided that we continue to keep the mark in use. We consider these marks, and the associated name recognition, to be valuable to our business.

Air Quality Standards

It is believed that with the increased worldwide focus on the greenhouse effects of petroleum products, the ability of Ethos to reduce emissions by 30% can only increase the Company's market presence. Political and media pressures are causing more people to become concerned about our environment and the effects of global warming. For example,

per the National Snow and Ice Data Center in Boulder, Colorado, the ice cover in the Arctic Ocean has shattered the all-time low record during the summer months of 2007. Most researchers had anticipated the complete disappearance of the Arctic ice pack during the summer months would not happen until after the year 2070, but now believe it could happen as early as 2030.

Ethos Environmental began the manufacturing and marketing of Ethos products after ten years of successful product testing. During the early years, widespread public environmental concerns were only beginning to surface. Air quality standards were non-existent and fuel costs were low, making penetration of the market an uphill battle.

Table of Contents

18

In recent years most of the improvements in air quality have come through advancements in engine technologies. Through catalytic converters and computer controlled air and fuel injection systems, engineers have designed cars that use fuel much more efficiently and pollute far less than ever before. But as new engine technologies have reached their limits, the government has turned its attention to the oil companies to produce cleaner-burning fuels.

The approach of Ethos Environmental is to sell our products “one gallon at a time”, earning the respect and trust of each user. Over the past decade, our products have gone through extensive miles of road tests, with all such testing verifying the ability of our products to significantly reduce emissions while improving gas mileage. Now, at a time of skyrocketing fuel costs, the value of Ethos products is paying off for a long list of domestic customers and a growing contingent of international clients.

Market Research

Air pollution caused by cars, trucks and other vehicles burning petroleum-based fuels is one of the most harmful and ubiquitous environmental problems. Furthermore, local accumulation in heavy traffic is the greatest source of community ambient exposure, largely because carbon monoxide is formed by incomplete combustion of carbon containing fuels.

Diesel exhaust is a major contributor of particulate matter concentrations. Representing only 2 percent of the vehicles on the road, diesel powered vehicles generate more than half of the particulates and nearly a third of the nitrogen oxides in the air, according to a study by the California Air Resources Board. Air pollution monitoring efforts by the American Lung Association indicate that diesel accounts for 70% of the cancer risk. Furthermore, pioneers in the study of global warming factors have come to believe that particulate matter, such as that emitted by diesel engines, plays a far more critical role in the development of the “greenhouse effect” than previously suspected.

To combat this problem the U.S. Environmental Protection Agency developed a two-step plan to significantly reduce pollution from new diesel engines. (New Emission Standards for Heavy-Duty Diesel Engines Used In Trucks and Buses) (October 1997, EPA 420-F-97-016). The first step set new emissions standards for diesel engines beginning in 2000. The second step sets even more stringent emission standards that will take effect in 2007, combined with mandated reductions in the sulfur levels of all diesel fuel.

As crude oil is heated, various components evaporate at increasingly higher temperatures. First to evaporate is butane, the lighter-than-air gas used in cigarette lighters, for instance. The last components of crude oil to evaporate, and the heaviest, include the road tars used to make asphalt paving. In between are gasoline, jet fuel, heating oil, lubricating oil, bunker fuel (used in ships), and of course diesel fuel. The fuel used in diesel engine applications such as trucks and locomotives is a mixture of different types of molecules of hydrogen and carbon and include aromatics and paraffin. Diesel fuel cannot burn in liquid form. It must vaporize into its gaseous state. This is accomplished by injecting the fuel through spray nozzles at high pressure. The smaller the nozzles and the higher the pressure, the finer the fuel spray and vaporization. When more fuel vaporizes, combustion is more complete, so less soot will form inside the cylinders and on the injector nozzles. Soot is the residue of carbon, partially burned and unburned fuel.

Sulfur is also found naturally in crude oil. Sulfur is a slippery substance and it helps lubricate fuel pumps and injectors. It also forms sulfuric acid when it burns and is a catalyst for the formation of particulate matter (one of the exhaust emissions being regulated). In an effort to reduce emissions, the sulfur content of diesel fuel is being reduced through the refinery process, however, the result is a loss of lubricity.

Diesel fuel has other properties that affect its performance and impact on the environment as well. The main problems associated with diesel fuel include:

Edgar Filing: Ethos Environmental, Inc. - Form 10-Q

- Difficulty getting it to start burning o Difficulty getting it to burn completely o Tendency to wax and gel
- With introduction of low sulfur fuel, reduced lubrication
- Soot clogging injector nozzles
- Particulate emissions
- Water in the fuel
- Bacterial growth

Table of Contents

19

Today's advanced diesel engines are far cleaner than the smoke-belching diesels of recent decades. Unfortunately, even smokeless diesel engines are not clean enough to meet current stricter air pollution regulations.

While diesel engines are the only existing cost-effective technology making significant inroads in reducing "global warming" emissions from motor vehicles, it is not sufficient to satisfy regulators and legislators. Diesel engines will soon be required to adhere to stringent regulatory/legislative guidelines that meet near "zero" tailpipe emissions, especially on smog-forming nitrogen oxides (NOx), particulate matter (PM) and "toxins"; the organic compounds of diesel exhaust.

The U.S. Department of Energy, Energy Information Administration ("EIA") estimates that U.S. annual consumption of fuel will continue to escalate through the year 2030.

A breakdown of this estimate is summarized as follows:

Based on further EIA published data, the following table* depicts domestic distillate fuel oil consumption by energy use for 2006.

When blended with fuels, Ethos products reduce the emissions of hydrocarbons (HC), nitrogen oxides (Nox) carbon monoxide (CO), particulate matter (PM) and other harmful compounds of combustion. Given these conditions, the commercial fuels consumer market represents an important target for Ethos Environmental.

Competition

The market for products and services that increase diesel fuel economy, reduce emissions and engine wear is rapidly evolving and intensely competitive and management expects it to increase due to the implementation of stricter environmental standards. Competition can come from other fuel additives, fuel and engine treatment products and from producers of engines that have been modified or adapted to achieve these results. In addition, we believe that new technologies, including additives, will further increase competition.

Alternative fuels, gasoline oxygenates and ethanol production methods are continually under development. A number of automotive, industrial and power generation manufacturers are developing more efficient engines, hybrid engines and alternative clean power systems using fuel cells or clean burning gaseous fuels. Vehicle manufacturers are working to develop vehicles that are more fuel efficient and have reduced emissions using conventional gasoline. Vehicle manufacturers have developed and continue to work to improve hybrid technology, which powers vehicles by engines that utilize both electric and conventional gasoline fuel sources. In the future, the emerging fuel cell industry offers a technological option to address increasing worldwide energy costs, the long-term availability of petroleum reserves and environmental concerns.

Table of Contents

The diesel fuel additive business and related anti-pollutant businesses are subject to rapid technological change, especially due to environmental protection regulations, and subject to intense competition. We compete with both established companies and a significant number of startup enterprises. We face competition from producers and/or distributors of other diesel fuel additives (such as Lubrizol Corporation, Chevron Oronite Company, Octel Corp., Clean Diesel Technologies, Inc. and Ethyl Corporation), from producers of alternative mechanical technologies (such as Algae-X International, Dieselcraft, Emission Controls Corp. and JAMS Turbo, Inc.) and from alternative fuels (such as bio-diesel fuel and liquefied natural gas) all targeting the same markets and claiming increased fuel economy, and/or a decrease in toxic emissions and/or a reduction in engine wear.

Ethos FR® and Ethos BFC are unique, and comparative fuel reformulators do not exist. The primary task for the Company is to distinguish itself as an industry leader in the reduction of fuel costs and emission problems at a profit gain to the commercial user. Part of the challenge before us is to differentiate Ethos products from two types of products in this industry, additives - that are purported to increase fuel mileage and oxygenates - which are mandated to lower emissions. Both provide short-term benefits at the price of long-term engine or environmental problems.

Additives contain highly refined petrochemicals or compressed hydrocarbons that promise better fuel mileage and sometimes lower emissions, by “cleaning” the engine. Used mainly by individual consumers, they are expensive and commonly sold at the auto parts and retail stores. More than five thousand EPA-registered fuel additives compete in the retail market and although the EPA requires that such products be registered, that registration constitutes neither endorsement nor validation of the product’s claims.

Oxygenates, such as methyl tertiary butyl ether (MTBE) and Ethanol, are intended to lower emissions by adding oxygen to the fuel. Ethos FR® products actually complement federally mandated oxygenates by lowering emissions, but as mentioned earlier, Ethos FR® is not an oxygenate and cannot be used for the purpose of complying with current language federal legislation.

In contrast, Ethos FR® products have cleaning properties that contribute to the lubrication of the engine instead of destroying it. The ester-based formula dissolves the gums and residues and adds important lubrication that an engine needs. The engine stays clean and lubricated, allowing it to run smoothly and efficiently.

Marketing Strategy

Ethos products are ideally positioned to capitalize on increasing fuel prices and regulatory pressure to tighten emissions standards. Fuel is a significant operating cost for companies that use cars, trucks or vessel fleets in their daily business, especially where competitive markets make it difficult to pass along fuel increases. Every hike in the price of fuel hurts the profitability of that company. For these businesses, obtaining better mileage offers a crucial competitive edge, and the goal of Ethos Environmental is to help them maximize their fuel use and maintain profitability.

From its earliest days, Ethos has focused on the product demonstration as the most effective means of introducing Ethos FR® to potential users. During this demonstration phase, Ethos supplies product to treat a sample of the fleet at no cost to the client. It is vital that the customer understand and prove the effectiveness of Ethos FR® in their fleets. This demonstration phase will last as long as necessary to quantify the value and projected savings possible once the entire fleet is treated.

Through this demonstration process, we prove to each customer that they can realize the benefits of reduced emissions, smoother-running vehicles and lower maintenance costs at virtually no risk, because the reduction in fuel usage will more than cover the expense of using Ethos FR®. In fact, the addition of Ethos FR® will result in fuel savings beyond the cost of treatment, resulting in monetary gain to the user.

Commercial fleets vary in size from a few to thousands of vehicles. Such fleets generally produce immediate sales results because administrative requirements are minimal and the product demonstration phase is brief. Typically, a sample of the fleet is treated and the potential customer is quickly able to quantify the value and project the savings that the use of Ethos FR® will produce. Usually a fleet's oldest and dirtiest vehicles, or vehicles out of warranty, are included in the demonstration. Such vehicles amplify the effectiveness of the products and help to ease any initial client objections regarding manufacturer warranties. Once the demonstration is underway, Ethos FR® products sell themselves, increasing fuel mileage between 7% and 19% and reducing emissions by more than 30%. Once the effectiveness of the product has been established, a conscientious customer-service program ensures continued use.

Table of Contents

21

Edgar Filing: Ethos Environmental, Inc. - Form 10-Q

The Ethos Environmental strategy has been to approach each market from the perspective of the customer's strongest motivation, whether to reduce fuel costs or reduce engine emissions. From a marketing standpoint, it is most cost-effective for Ethos Environmental to focus on commercial fuel users that keep track of maintenance and operating expenses. These consumers are more sensitive to pressures from rising fuel costs and more concerned about meeting emissions standards.

Rising fuel costs will always be a marketing advantage for Ethos. Higher fuel prices decrease the cost to treat each gallon of fuel; resulting in even greater savings to Ethos clients. The Company's marketing strategy strengthens as the price of fuel increases. Even where cost savings are a client's primary motivator, the use of Ethos FR® identifies the user as an environmentally conscientious business. It also creates goodwill within the community through the reduction of unhealthy and unsightly exhaust emissions.

As the following table indicates, over the past ten years, the average monthly spot price per barrel of oil (FOB) has increased dramatically from \$11.35 in December 1998 to \$133.88 in June 2008, and continues to rise.

1998	16.72	16.06	15.12	15.35	14.91	13.72	14.17	13.47	15.03	14.46	13.00	11.35
1999	12.51	12.01	14.68	17.31	17.72	17.92	20.10	21.28	23.80	22.69	25.00	26.10
2000	27.26	29.37	29.84	25.72	28.79	31.82	29.70	31.26	33.88	33.11	34.42	28.44
2001	29.59	29.61	27.24	27.49	28.63	27.60	26.42	27.37	26.20	22.17	19.64	19.39
2002	19.71	20.72	24.53	26.18	27.04	25.52	26.97	28.39	29.66	28.84	26.35	29.46
2003	32.95	35.83	33.51	28.17	28.11	30.66	30.75	31.57	28.31	30.34	31.11	32.13
2004	34.31	34.68	36.74	36.75	40.28	38.03	40.78	44.90	45.94	53.28	48.47	43.15
2005	46.84	48.15	54.19	52.98	49.83	56.35	59.00	64.99	65.59	62.26	58.32	59.41
2006	65.49	61.63	62.69	69.44	70.84	70.95	74.41	73.04	63.80	58.89	59.08	61.96
2007	54.51	59.28	60.44	63.98	63.45	67.49	74.12	72.36	79.91	85.80	94.77	91.69
2008	92.97	95.39	105.45	112.58	125.40	133.88						

Source: U.S. Energy Information Administration

Ethos FR – Proof of Performance

An integral part of our sales process is to conduct proof of performance demonstrations for potential customers wherein we accumulate historical data that documents the effects of the use of Ethos FR® (i.e. advantages in terms of increased fuel economy, a decrease in engine wear and reductions in toxic emissions) on that customer's specific vehicles or vessels. In connection with the proof of performance demonstrations, we provide fleet monitoring services and forecasts of fuel consumption for purposes of the prospective customer's own analysis.

The results below are test results of customer experiences using Ethos FR®. The first results are for a fleet of trucks for Allied Waste. The second results are for Ecuador for Ethos BFC used in external combustion engines. On our website are results for other customers including: US Department of Justice; LA Transport; Lucar Transport; Mission Linen Supply; Vista City; China City Bus Company; Oceanside School District; San Diego Port District; and the Shenzhen Public Transport Group. In all tests the results have been consistent, with a 7% to 19% cost saving, and an over 30% reduction in emissions.

Following is a Management Report outlining the process and methodology of the testing of Ethos FR® for Allied Waste Services.

Table of Contents

MANAGEMENT REPORT

Testing of Ethos Fuel Reformulator
Allied Waste Services, Southwestern Region

Overview

Ethos FR has been used, without interruption, at multiple Allied Waste locations in Southern California since the year 2001.

Based on the positive results realized at those locations (estimated at a 10 reduction in fuel consumption plus significant reductions in maintenance/repair costs and emissions) an initial test was conducted at one location in the Southwestern Region of Allied Waste during the months of July and August, 2006. The results of this initial 4 week test showed an estimated reduction in fuel consumption of 10.35%, as measured by gallons per engine hour, compared to a baseline period of the previous 12 months (July 2005 through June 2006).

Based on these positive results, a second phase of testing was initiated in May 2007 encompassing 4 locations in the Southwestern Region. The period of testing was generally the months of May, June and July 2007, however, one location continued Ethos use through August. The detailed data obtained from this testing period is content of this report.

Testing Procedures and Data Compilation & Reporting Methodology

Upon initiation of the testing period, fuel consumption and engine hour data was obtained from each location for a baseline period in order to establish a point of comparison for the test. The baseline period for each location was generally the period of January through March, 2007.

The standard CFA report obtained from each location was the "Fuel Transaction Detail by Equipment #" report. This report provides the most comprehensive daily listing of fuel dispensed and engine hours recorded for each vehicle during each time period. It is important to note that detailed reports were used throughout the compilation of the data contained in this analysis because every report from every location contains several "anomalies" which could distort the accuracy of any data from any report.

Most common among these "anomalies" are:

1. Vehicles showing fuel consumed but few or no engine hours recorded (which would result in a higher fuel per hour calculation than is actually the case),
2. Vehicles showing no fuel consumed yet have engine hours recorded (which would result in a lower fuel per hour calculation than is actually the case), or
3. Vehicles that do not have recorded data for both comparative periods. This would include:
 - new vehicles that have been added to the fleet (and therefore have no baseline data)
 - vehicles that have been retired from the fleet or are out of service for repairs or maintenance (these vehicles will have baseline data but no data in one or more of the test periods).

Raw Data vs. Comparable Data

Due to the frequency and significance of the anomalies outlined above, a detailed process was implemented to ensure that any such reporting inaccuracies did not undermine the validity of the comparative data obtained during this test.

The procedures utilized by Green Fleet Associates were as follows:

Edgar Filing: Ethos Environmental, Inc. - Form 10-Q

1. Every CFA report that was obtained from every location for every time period as reviewed line-by-line, vehicle-by-vehicle to assure the validity of the data. Any obvious anomalies were highlighted on the raw CFA report.
2. This raw data from the CFA report was transferred to a spreadsheet in order to facilitate ongoing side-by-side, vehicle-by-vehicle comparisons of baseline to test period data. Any anomalies or missing data for any vehicle was highlighted on the spreadsheet for reach comparative period.
3. A true “apples-to-apples” comparison was obtained for each time period by removing all highlighted items.

Table of Contents

23

Verification of Ethos Use

Equally important in assuring the validity of the data collected was making best efforts to verify that all of the fuel being consumed by each location during the testing period was being treated with Ethos. The method utilized to check this compliance was a detailed tracking of fuel deliveries compared the Ethos inventory at each location during the testing period. While almost all locations maintained a consistent treatment schedule throughout the three month testing period, there were some minor exceptions.

The spreadsheets detailing the baseline & test period data, for each month at each location are as follows:

Table of Contents

24

Following is a summary of the test results for Ethos Bunker Fuel Conditioner, tested at Esmeraldas, Ecuador.

- 1.) O₂ levels increased by 41.53 % after the application of the Ethos Bunker Fuel Conditioner.
- 2.) CO₂ levels decreased by 7.79% after the application of the Ethos BFC.
- 3.) CO levels decreased by 91.75 % after the application of the Ethos Bunker Fuel Conditioner.
- 4.) SO₂ levels decreased by 1.69% after the applications of the Ethos BFC.
- 5.) NO levels decreased by .82% after the application of the Ethos BFC.
- 6.) NO₂ levels remained constant at 0.
- 7.) Nox levels decreased by .82% after the application of the Ethos BFC.
- 8.) tf levels decreased by 9.18% after the application of the Ethos BFC.
- 9.) ta levels decreased by 1.16% after the application of the Ethos BFC.
- 10.) CO₂ max levels decreased by .69% after the application of Ethos BFC.
- 11.) Excess air readings increased by 48.14% after the application of the Ethos BFC.

Table of Contents

25

Ethos FR – Proof of Performance Demonstrations

Ethos Environmental's fuel reformulating products reduce emissions by burning fuel more completely, which improves fuel mileage. Exhaust is essentially unburned fuel, wasted fuel, so when the fuel is used more completely the engine delivers better mileage from every tank. Efficient fuel use also means improved engine performance because a more complete combustion process obtains increased power from each engine revolution.

In the last decade hundreds of thousands of miles in road tests have been conducted. Test after test, Ethos products have proven to reduce engine exhaust emissions by 30% and more, including measurable reductions in the emissions of hydrocarbons (HC), nitrogen oxides (NOx), carbon monoxide (CO), and sooty exhaust or particulate matter (PM). All of these emissions are highly toxic and as a result, fuel mileage increases have been significant, ranging from 7% to 19% fleet wide.

Ethos Environmental uses an opacity meter, a detection device for diesel vehicles that measures the percentage of opacity (light obstructed from passage through an exhaust smoke plume), to demonstrate dramatic reductions in emissions. In more than 1,000 heavy-duty diesel vehicles treated (a motor vehicle having a manufacturer's maximum gross vehicle weight rating (GVWR) greater than 6,000 pounds), emissions were lowered by as much as 90%. The Society of Automotive Engineers (SAE) recommended practice SAE J1667 "Snap Acceleration Smoke Test Procedure" to be used for heavy-duty diesel powered vehicles. Attached are samples of opacity test sheets, taken from diesel-powered engines, demonstrating the positive results after using Ethos FR®.

Table of Contents

26

Target Markets

According to the American Petroleum Institute, the United States fuels consumer market is comprised of the following segments: retail consumer 27%, government agencies 16%, ground fleets 14%, industrial users 10%, aircraft 9%, maritime 6%, miscellaneous 18%.

The Company's typical customers use cars, trucks or vessels in their day-to-day operations. Fuel is a significant operating cost, and consequently these fleets are particularly sensitive to fuel price fluctuations and strict emissions standards. The ideal clients are those with fleet managers and are conscientious about keeping track of operating expenses. They understand that every hike in fuel price hurts their profitability, this being a critical factor wherever competitive markets make it difficult to pass on the price increases to their clients; thereby making it critical for businesses to obtain better mileage as a competitive advantage.

Maritime and government agencies are desirable for their large fuel volume use and industry credibility. They offer the Company medium to long-term sales, since the process requires a longer lead-time to close. The product demonstration phase and administrative requirements are generally more complex, particularly with large government institutions. At the same time, they offer large volume sales and a continual source of staged orders that promote production stability.

Marine vessels run on bunker fuel that is less refined than diesel. A mid-size ship will use more than half a ton per hour of operation, or 125 gallons of fuel per hour. For example, a mid-size vessel running on bunker on a typical trip to Japan from Los Angeles will require a half ton per hour, or 180 tons. This represents a total of 45,000 gallons of fuel that requires 4,500 oz. (35 gallons) of Ethos BFC. This vessel would use approximately one drum (55gals.) of Ethos BFC per month. Accordingly, maritime customers represent a large and solid client base.

Countries all around the world are endeavoring to deal with the high costs of petroleum products and the detrimental effects of those products on the environment, much like the United States. The Company has found broad and enthusiastic acceptance of its Ethos products globally. During the past three years, the Company has opened markets in Asia, Latin America, Canada, Australia, Africa and Europe, often dealing directly with government entities that possess the power to implement widespread use of Ethos products – whether in citywide public transportation systems or countrywide fuel distribution structures.

As with our domestic client base, international customers of Ethos appreciate the benefits of improved mileage and reduced emissions. In countries that lack the regulatory structures necessary to control vehicle emissions and fuel efficiency, the benefits of Ethos are even more pronounced.

Table of Contents

27

Customers

We have a very diversified customer list. Although we have many customers utilizing products, the broadly diversified base means there is no significant concentration in any industry. We derive revenue from our customers as discussed in Note 1, "Organization and Significant Accounting Policies: Revenue Recognition" of the consolidated financial statements. Two U. S. customers accounted for approximately 90% of our revenues for the three and six months ended June 30, 2008.

Supply Arrangements

We presently obtain our raw materials on an exclusive basis from five (5) suppliers. However, these arrangements are not governed by any formal written contract. Accordingly, either party may terminate the arrangement at any time, including the exclusivity aspect of the arrangement. If a supplier is not able to provide us with sufficient quantities of the product, or chooses not to provide the product at all (for any reason), or if exclusivity is lost, business and planned operations could be adversely affected. Although management has identified alternate suppliers of the products, no assurance can be given that the replacement products will be comparable in quality to the product presently supplied to us by current suppliers, or that, if comparable, products can be acquired under acceptable terms and conditions.

Revenue and Fixed Assets

The Company's revenue is generated in the United States and abroad through our San Diego, California office, which at present is our only operating office. All of the fixed assets are located in the San Diego, California office. In February, 2007, the Company entered into a sale and leaseback arrangement as outlined below under Loan Facilities. In October 2007, the Company completed the Commercial Property Purchase Agreement executed in August 2007, and reported on Form 8-K on August 13, 2007.

Vendors

The Company maintains strong relationships with all vendors. We are not dependent upon any one vendor for our business.

Governmental Regulation

In the United States, fuel and fuel additives are registered and regulated pursuant to Section 211 of the Clean Air Act. 40 CFR Part 79 and 80 specifically relates to the registration of fuels and fuel additives. Typically, there are registration and regulation requirements for fuel additives in each country in which they are sold. In accordance with the Clean Air Act regulations at 40 CFR 79, manufacturers (including importers) of gasoline, diesel fuel and additives for gasoline or diesel fuel, are required to have their products registered by the EPA prior to their introduction into commerce.

However, EPA registered additives are derived from petroleum while Ethos FR® is a reformulator. Even though you "add it" to the fuel, Ethos FR® is not derived from petroleum and is non-toxic and non-hazardous and therefore not subject to governmental regulations. There could be unforeseen future changes to the registration requirements under the Clean Air Act and Ethos FR® may have to seek registration under such new requirements. In addition, we currently sell our product outside of the United States and intend to further expand our sales efforts internationally. We may need to seek registration in other countries for the Ethos FR® product.

At this time the Company is not aware of any present or pending rules or regulations that would require the Company to seek registration of the Ethos FR® product either domestically or internationally.

Research and Development Costs

Research and development costs are charged to operations when incurred and are included in operating expenses.

Following is the Ethos FR® Material Safety Data Sheet (MSDS)

Table of Contents

28

Table of Contents

29

Following is the Ethos FR® Material Safety Data Sheet (MSD

Table of Contents

30

Available Information

We file electronically with the Securities and Exchange Commission our annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K, pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. You may obtain a free copy of our reports and amendments to those reports on the day of filing with the SEC by going to <http://www.sec.gov>.

Critical Accounting Policies and Estimates

We believe that there are several accounting policies that are critical to understanding our historical and future performance, as these policies affect the reported amounts of revenue and the more significant areas involving management's judgments and estimates. These significant accounting policies relate to revenue recognition, research and development costs, valuation of inventory, valuation of long-lived assets and income taxes. For a summary of our significant accounting policies (which have not changed from December 31, 2007), see our annual report on Form 10-KSB for the period ended December 31, 2007.

RESULTS OF OPERATIONS FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2008 AS COMPARED WITH THE THREE AND SIX MONTHS ENDED JUNE 30, 2007

The following analysis of historical financial condition and results of operations are not necessarily reflective of the on-going operations of the Company.

Revenues

We recognized revenues of \$1,286,884 for the three months ended June 30, 2008 compared to revenues of \$2,599,962 for the same period in the prior year, a decrease of \$ 1,313,078 or 51%. The primary source of revenue for the period ended June 30, 2008 was from the sale of Ethos FR®. During 2007, the Company had a large order of Ethos Bunker Fuel to Ecuador which was not repeated in the first quarter of 2008.

We recognized revenues of \$ 2,391,352 for the six months ended June 30, 2008 compared to revenues of \$ 5,297,095 for the same period in the prior year, a decrease of \$ 2,905,743 or 55%. The primary source of revenue for the period ended June 30, 2008 was from the sale of Ethos FR®. During 2007, the Company had large orders of Ethos Bunker Fuel to Ecuador, totaling \$4,450,205, which were not repeated in the first six months of 2008.

We expect our growth to continue as sales increase and the sales and marketing strategies are implemented into the targeted markets and we create an understanding and awareness of our technology through proof of performance demonstrations with potential customers.

Our future growth is significantly dependent upon our ability to generate sales. Our main priorities relating to revenue are: (1) increase market awareness of Ethos FR® product through our sales and marketing plan, (2) growth in the number of customers and vehicles per customer, and (3) providing extensive customer service and support.

Gross Profit

Gross profit, defined as revenues less cost of goods sold, was \$882,460 or 69% of sales for the three months ended June 30, 2008, compared to \$1,814,665 or 70% of sales for the same period ended June 30, 2007. In terms of absolute dollars, gross profit decreased 51% for the three months ended June 30, 2008 compared to same period in the prior year due primarily to the reduction in gross revenue.

For the six month period ending June 30, 2008 gross profit was \$1,639,739 or 69% of sales, compared to \$3,587,154 or 68% of sales for the same period ended June 30, 2007. In terms of absolute dollars, gross profit decreased 54% for

the six months ended June 30, 2008 compared to same period in the prior year due primarily to the reduction in gross revenue.

Cost of goods sold was \$404,424 for the three months ended June 30, 2008, which represented 31% of revenues compared to \$785,297 for the comparable period in the prior year, which represented 30% of revenues.

Cost of goods sold was \$751,613 for the six months ended June 30, 2008, which represented 31% of revenues compared to \$1,709,941 for the comparable period in the prior year, which represented 32% of revenues.

Table of Contents

31

Operating Expenses

Our current operating expenses are comprised of costs associated with administrative, salary, marketing, legal and business development. We will have additional operating expenses for additional staff members as they are hired. We have allocated funds in our capital structure for our current expenses.

General and Administrative expenses incurred during the three months ended June 30, 2008 totaled \$2,061,269. These expenses were incurred as follows:

Accounting, audit, bookkeeping and director fees	\$ 55,688
Legal fees	\$ 17,752
Business consulting fees	\$ 15,000
Outside Services	\$ 9,309
Office expenses	\$ 131,865
Depreciation	\$ 2,134
Stock Issued for expenses	\$ 1,175,201
Stock Issued for services	\$ 87,515
Salaries and Wage expense	\$ 243,729
Taxes	\$ 5,681
Rent	\$ 206,072
Equipment Rental	\$ 91,323
Research & Development	\$ 20,000

Similar expenses incurred for the three months ended June 30, 2007 were \$2,053,897 and were incurred primarily for expenses of a similar nature.

Also, for comparison purposes, there were 1,896,106 newly issued shares for the payment of expenses, and 206,578 shares newly issued for services during the three months ended June 30, 2008, compared to 483,500 shares issued for services during the three months ended June 30, 2007. For the six months ended June 30, 2008, the shares issued were 2,265,428 and 313,128, respectively.

Research and Development Costs

Research and development costs are charged to operations when incurred and are included in general and administrative expenses. The amounts expensed for the three months ended June 30, 2008 and 2007 amounted to \$20,000 and \$7,500, respectively.

The company continues to strive to improve its products, packaging, etc., and to develop new products for the future.

Net Loss

We realized a net loss for the three months ended June 30, 2008 of \$1,273,683 as compared to a net loss of \$7,243,577 for the comparable prior year period. For the six months ended June 30, 2008 and 2007, the Company realized net losses of \$1,859,520 and \$8,167,983, respectively.

NON-OPERATING INCOME AND EXPENSES

Edgar Filing: Ethos Environmental, Inc. - Form 10-Q

Non-operating income, net of expenses, decreased in the quarter ended June 30, 2008 to \$0 versus \$35 in 2007. Interest expense decreased to \$38,400 during the 3 months ended June 30, 2008 from \$200,632 the comparable period in 2007. The interest difference was directly associated with promissory notes issued during the quarter ended March 31, 2008 versus an interest only note in the amount of \$4,750,000 during 2007. The latter note was paid in October 2007.

Table of Contents

32

Liquidity and Capital Resources

During the three months ended June 30, 2008, we had a working capital of \$6,498,935 and stockholders' equity of \$7,421,707 compared to a working capital of \$2,504,247 and stockholders' equity of \$4,050,165 during the comparable period in the prior year.

On June 30, 2008, the Company had \$133,970 in cash, total assets of \$9,337,573 and total liabilities of \$1,915,865, compared to \$12,857 in cash and \$300,000 in restricted cash, total assets of \$10,930,284 and total liabilities of \$6,880,119 on June 30, 2007.

We anticipate, based on currently proposed plans and assumptions relating to our operations, that our current cash and cash equivalents together with projected cash flows from operations and projected revenues will be sufficient to satisfy our contemplated cash requirements for the next 12 months. Our contemplated cash requirements for 2008 and beyond will depend primarily upon the level of sales of our products, inventory levels, product development, sales and marketing expenditures and capital expenditures.

Management of the Company has undertaken steps as part of a plan with the goal of sustaining the Company operations for the next twelve months and beyond. These steps include: (a) attempting to raise additional capital and/or other forms of financing; (b) controlling overhead and operating expenses; and (c) continuing to increase the sales of its fuel reformulating product. There can be no assurance that any of these efforts will be successful.

Loan Facilities

In exchange for an aggregate amount of \$1,000,000 cash investment received on January 30, 2008, on March 26, 2008, the Company issued a Secured Promissory Note (the "Note"). The Note of \$1,000,000 bears interest at 12% per annum. The note matured and became due on July 30, 2008, as of the date of this report the Company has repaid and satisfied the Note in full. In order to do so, the Company received a Nonrecourse Loan in the amount of \$500,000 from its Chief Executive Officer in order to satisfy the amount due and owing under the Note.

Additionally, in exchange for an aggregate amount of \$300,000 cash investment received on March 31, 2008, the Company issued a promissory note. The promissory note is in the original principal amount of \$300,000 and bears interest at 12% per annum, which is payable monthly in arrears. The promissory note is due on March 31, 2009.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to our investors.

PLAN OF OPERATIONS FOR THE NEXT TWELVE MONTHS

Since inception in 2000, Ethos Environmental has grown its customer base to thousands of diverse clients in over 21 countries worldwide. In addition to an effective and desirable product, the company's success also derives from the careful development and tenacious implementation of a structured "proof-of-concept" marketing strategy.

Throughout this "proof-of-concept" sales and marketing phase, gross sales for Ethos Environmental have consistently exceeded forecasts, reaching more than \$1.78 million by the end of 2005, \$4.77 million by the end of 2006 and \$10.38 million in 2007. Even more significant growth is anticipated for 2008, with sales in established markets in the U.S., Asia, Latin America, Europe, Africa and Australia expected to top current forecasts. Furthermore, market implementation plans anticipate gross multi million sales in 2008 and beyond. These projections are based on the product's proven ability to improve fuel efficiency while reducing emissions, the Company's proven ability to penetrate

new markets and build a solid base of loyal customers, and the world's increasing costs in the petro-economic markets.

Looking forward, marketing will constitute a significant portion of company expenditures as Ethos Environmental continues to develop sales of new ester-based fuel and engine enhancing products. We are in the process of developing new products covering areas of synthetic oils, sulfur substitutes, and varied formulations of the original Ethos FR® and its enhancements.

Table of Contents

33

The management of Ethos Environmental is excited by the enthusiastic acceptance that Ethos FR® products have received - domestically and all around the world. We are proud to provide a product that is part of the solution to the high cost of fuel and the health costs of environmental pollutants. Since inception management has been focused on the development of a solid infrastructure, building relationships and establishing the foundation of a business that will continue to grow - non-stop - into the future.

Critical Accounting Policies

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make a wide variety of estimates and assumptions that affect (i) the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements, and (ii) the reported amounts of revenues and expenses during the reporting periods covered by the financial statements. Our management routinely makes judgments and estimates about the effect of matters that are inherently uncertain. As the number of variables and assumptions affecting the future resolution of the uncertainties increases, these judgments become even more subjective and complex. The most significant accounting policies that are most important to the portrayal of our current financial condition and results of operations are as follows:

Revenue Recognition

The Company recognizes revenue in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104 (“SAB 104”), “Revenue Recognition in Financial Statements”. Revenue consists of the sale of products and is recognized only when the price is fixed or determinable, persuasive evidence of an arrangement exists, the product is shipped, and collectability is reasonably assured.

Table of Contents

34

ITEM 4(T). CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures:

Our President and Chief Financial Officer, after evaluating the effectiveness of our “disclosure controls and procedures” (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)), have concluded that, as of March 31, 2008 due to the material weaknesses in our internal control over financial reporting identified in our 2007 Form 10-KSB, our disclosure controls and procedures were not effective in providing reasonable assurance that information we are required to disclose in reports we file is recorded, processed, summarized and reported within the periods specified.

(b) Management’s Annual Report on Internal Control Over Financial Reporting:

While we have continued our efforts to address each of the material weaknesses identified in our 2007 Form 10-KSB, there were no material changes in our internal control over financial reporting during the most recently completed quarter. We have not identified any additional material weaknesses during this quarter. We are not planning to report on whether there has been full remediation of the identified material weaknesses until our 2008 report on internal control over financial reporting is complete.

(c) Changes in Internal Control Over Financial Reporting:

There were no changes in our internal control over financial reporting during the three months ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

During 2008, the company will be directing concerted focus to full compliance with Sarbanes-Oxley requirements, as revised in Audit Standard No. 5 for small businesses, in implementing Section 404(a) of the Act.

Table of Contents

35

PART II.

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are involved in routine legal matters incidental to our business. In the opinion of management, the ultimate resolution of such matters will not have a material adverse effect on our financial position, results of operations or liquidity.

The Company became a defendant in a lawsuit filed by Accutek, Inc. of Vista, CA for an outstanding balance on equipment purchased in the amount of \$43,000. The Company has filed a cross-complaint asserting that the contractual obligations of the supplier, Accutek were not fulfilled. The proceeding is pending as of the date of this report.

The Company became a defendant in a lawsuit filed by Groovie Like A Movie in the amount of \$19,950. The Company has filed a cross-complaint claiming non-delivery of goods and services. The proceeding is pending as of the date of this report.

The Company also became a defendant in a lawsuit filed by the Bedrock Group in Arizona in May 2008. Settlement negotiations are underway, and the Company expects to be able to settle this matter shortly.

ITEM 1(A). RISK FACTORS

Not required.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

On August 11, 2008, Ethos Environmental, Inc. (the "Company") entered into a Stock Purchase Agreement and a Note and Warrant Purchase Agreement (the "Purchase Agreements") with MKM Opportunity Master Fund, Limited, a Cayman Islands corporation (the "Buyer") a non-affiliated investors pursuant to which, in exchange for an aggregate payment of \$600,000 in cash (the "Financing Transaction").

Pursuant to the terms of the Stock Purchase Agreement the Company sold to Buyer 909,091 shares of the Company's Common Stock for an aggregate purchase price of \$300,000. In connection with the sales of Common Stock pursuant to the Stock Purchase Agreement, the Company entered into a Securities Purchase Agreement with Buyer whereby the Company sold to Buyer one Unit in the aggregate principal amount of \$300,000. The Unit included (i) a convertible promissory notes (the "Note") and (ii) a warrants to purchase in the aggregate 1,000,000 shares of the Company's common stock (the "Common Stock") at an exercise price of \$0.25 per share (the "Warrants") (collectively the shares underlying the Stock Purchase, Note and Warrant are referred to herein as the "Securities"). Both Purchase Agreements contain standard representations, and warranties and affirmative and negative covenants. The Notes and the Warrants are described in greater detail below.

The Note carries a six month maturity date and the Buyer holds the right to convert thereafter at a rate of \$0.25 per share, upon maturity the Note is equal to 120% of the face value, or \$360,000. Thereafter if the Note is not satisfied or converted the Note shall carry 10% interest. The Notes also contain customary events of default. The Warrants are exercisable for an aggregate of 1,000,000 shares of Common Stock at an exercise price of \$0.75 per share prior. The Warrants may be exercised by the Investors by making payment in full of the exercise price either in cash or by written instruction directing the Company to cancel or surrender a portion of the Warrants to satisfy payment of the exercise price. Payment by such cancellation or surrender is deemed a "cashless exercise."

The respective descriptions of (i) Stock Purchase Agreement (ii) the Notes, (ii) the Warrants and (iii) the Securities Purchase Agreements are brief summaries only and are qualified in their entirety by their respective terms set forth in each document, forms of which are filed as exhibits hereto.

The Securities offered in the Financing Transaction, have not been registered under the Securities Act of 1933, as amended (the “Securities Act”), and may not be offered or sold in the United States absent the registration or an applicable exemption from the registration requirements of the Securities Act. The transactions contemplated by the Purchase Agreements are exempt from the registration requirements of the Securities Act, pursuant to Section 4(2) and/or Regulation D thereunder. Pursuant to the Purchase Agreements, the Buyer made representations to the Company regarding their respective suitability to invest in the Private Placement, including, without limitation, that each Investor qualifies as an “accredited investor” as that term is defined under Rule 501(a) of the Securities Act. The Company did not engage in general solicitation in connection with the sale of the Securities.

Table of Contents

36

Edgar Filing: Ethos Environmental, Inc. - Form 10-Q

This Current Report shall not constitute an offer to sell, the solicitation of an offer to buy, nor shall there be any sale of these securities in any state in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such state.

The Securities of Company common stock issued to the Buyer pursuant to the terms of the Financing Transaction were issued in reliance on Section 4(2) under the Securities Act and Regulation D promulgated thereunder in a transaction not involving a public offering.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

On March 26, 2008, the Company issued a 12% Secured Promissory Note (the "Applegate Note") in favor of Patricia Applegate in the amount of \$1,000,000. The note matured and became due on July 30, 2008, as of the date of this report the Company has repaid and satisfied the Applegate Note in full. The Company received a Nonrecourse Loan in the amount of \$500,000 from its Chief Executive Officer in order to satisfy the amount due and owing under the Applegate Note.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits.

EXHIBIT NUMBER	DESCRIPTION	LOCATION
3.1 - 3.2	Articles of Incorporation and Bylaws	Previously Filed.
10.1	Note and Warrant Purchase Agreement	Filed herewith
10.2	Convertible Note	Filed herewith
10.3	Securities Purchase Agreement	Filed herewith
10.4	Common Stock Purchase Warrant	Filed herewith
31.1	Rule 13a-14(a)/15d-14(a) Certification (CEO)	Filed herewith
31.2	Rule 13a-14(a)/15d-14(a) Certification (CFO)	Filed herewith
32.1	Section 1350 Certification (CEO)	Filed herewith
32.2	Section 1350 Certification (CFO)	Filed herewith

(b) Reports on Form 8-K.

During the six months ended June 30, 2008, we filed the reports on Form 8-K on the following dates:

- (1) January 24, 2008
- (2) January 24, 2008
- (3) January 24, 2008
- (4) March 27, 2008
- (5) April 4, 2008

Table of Contents

37

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ETHOS ENVIRONMENTAL, INC.
(Registrant)

Date: August 14, 2008

By: /s/ Enrique de Vilmorin
Enrique de Vilmorin
President and CEO

Table of Contents

38
