

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2015

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-33155



**COATES INTERNATIONAL, LTD.**

(Exact name of registrant as specified in its charter)

**Delaware**

**22-2925432**

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification No.)

**2100 Highway 34 & Ridgewood Road, Wall Township, New Jersey 07719**

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(732) 449-7717**

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

Title of each class:

Name of each exchange on which registered:

**None**

**None**

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

(Title of class)

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark 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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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 Act). Yes  No

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter: \$3,851,000.

As of April 11, 2016, the number of outstanding shares of the registrant's common stock, par value \$0.0001 per share was 1,349,268,227.

Documents Incorporated by Reference: None.

**COATES INTERNATIONAL, LTD.**  
**ANNUAL REPORT ON FORM 10-K**  
**DECEMBER 31, 2015**

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## FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K (this “Report”) contains “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Exchange Act of 1934, as amended. Forward-looking statements discuss matters that are not historical facts. Because they discuss future events or conditions, forward-looking statements may include words such as “anticipate,” “believe,” “estimate,” “intend,” “could,” “should,” “would,” “may,” “seek,” “plan,” “might,” “will,” “expect,” “predict,” “project,” “forecast,” “potential,” “continue” negatives thereof or similar expressions. These forward-looking statements are found at various places throughout this Report and include information concerning possible or assumed future results of our operations; business strategies; future cash flows; financing plans; plans and objectives of management; any other statements regarding future operations, future cash needs, business plans and future financial results, and any other statements that are not historical facts.

From time to time, forward-looking statements also are included in our other periodic reports on Forms 10-Q and 8-K, in our press releases, in our presentations, on our website and in other materials released to the public. Any or all of the forward-looking statements included in this Report and in any other reports or public statements made by us are not guarantees of future performance and may turn out to be inaccurate. These forward-looking statements represent our intentions, plans, expectations, assumptions and beliefs about future events and are subject to risks, uncertainties and other factors. Many of those factors are outside of our control and could cause actual results to differ materially from the results expressed or implied by those forward-looking statements. In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than we have described. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this Report. All subsequent written and oral forward-looking statements concerning other matters addressed in this Report and attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this Report.

Except to the extent required by law, we undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events, a change in events, conditions, circumstances or assumptions underlying such statements, or otherwise.

For a discussion of factors that we believe could cause our actual results to differ materially from expected and historical results see “Item 1A — Risk Factors” below.

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## PART I

### Item 1. Business

#### General

Coates International, Ltd. ("we" or the "Company") has been developing over a period of more than 20 years a patented Coates Spherical Rotary Valve<sup>®</sup> ("CSR<sup>®</sup>V") system technology which is adaptable for use in piston-driven internal combustion engines of many types. Independent testing of various engines in which we incorporated our CSR<sup>®</sup>V system technology ("CSR<sup>®</sup>V Engines") confirmed meaningful fuel savings when compared with internal combustion engines based on the conventional "poppet valve" assembly prevalent in most internal combustion engines throughout the world. In addition, our CSR<sup>®</sup>V Engines produced only ultra-low levels of harmful emissions while in operation. Engines operating on the CSR<sup>®</sup>V system technology can be powered by a wide selection of fuels. We believe that these three major advantages of the CSR<sup>®</sup>V system technology constitute the first revolutionary technological advancement of the internal combustion engine suitable for large scale production since its introduction more than one hundred years ago.

The CSR<sup>®</sup>V system is designed to replace the intake and exhaust conventional "poppet valves" currently used in almost all piston-driven stationary, automotive, motorcycle, and marine engines. Unlike conventional valves which protrude into the engine combustion chamber, the Coates<sup>®</sup> rotary valve system utilizes spherical valves that rotate in a cavity formed between a two-piece cylinder head. The Coates rotary valve system uses approximately 1/10th the moving parts of conventional poppet valve assemblies. As a result of these design improvements, management believes that the engines incorporating the Coates rotary valve system (Coates engines<sup>®</sup>) will last significantly longer and will require less lubrication over the life of the engine, as compared to conventional engines. In addition, Coates rotary valves can be designed with a larger opening into the engine cylinder than conventional valves so that more fuel and air can be inducted into and expelled from the cylinder in a shorter period of time. Larger valve openings permit higher revolutions-per-minute (RPM's) and permit higher compression ratios with lower combustion chamber temperatures, allowing the Coates engine<sup>®</sup> to produce more power than equivalent conventional engines. The CSR<sup>®</sup>V engine is a highly thermal-efficient power unit.

We have been granted an exclusive license to this technology from our founder, George J. Coates and his son, Gregory G. Coates (the "Coates License Agreement"), in the Territory defined to include North America, Central America and South America (the "Americas").

Since our inception, the bulk of our development costs and related operational costs have been funded primarily through cash generated from the sales of our common stock, issuances of promissory notes and convertible promissory notes, capital contributions, sales of a small number of natural gas powered CSR<sup>®</sup>V industrial electric power generator sets ("Gen Sets"), a gain on the sale of the land and building that serves as our principal facility, from the performance of contractual research and development activities involving the CSR<sup>®</sup>V system technology and the receipt of licensing fees for our CSR<sup>®</sup>V system technology. During the years ended December 31, 2015 and 2014, we did not have any sales and we had revenues from research and development of \$94,200 and \$19,200, respectively. For the years ended December 31, 2015 and 2014, we incurred net losses of approximately (\$10,204,000) and (\$12,790,000), respectively. The accumulated net losses from inception of the Company through December 31, 2015 amounted to approximately (\$56,971,000). We may continue to be unprofitable until the CSR<sup>®</sup>V Engine is successfully introduced into the marketplace, or we receive substantial licensing revenues. These accumulated losses were substantially related to research and development of our intellectual property, patent filing and maintenance costs, costs incurred related to efforts to raise additional working capital and general and administrative expenses in connection with our operations. During the year ended December 31, 2015, we raised \$1,108,000 of new working capital from issuances of convertible promissory notes, sales of registered shares of common stock under equity purchase agreements and issuances of promissory notes to related parties.

Coates International, Ltd. is a Delaware corporation organized in October 1991 as successor-in-interest to a Delaware corporation of the same name incorporated in August 1988. Our operations are located in Wall Township, New Jersey (approximately 60 miles outside of New York City). We maintain a website at the following address: [www.coatesengine.com](http://www.coatesengine.com). Through a link on our website to the U.S. Securities and Exchange Commission ("SEC") website, [www.sec.gov](http://www.sec.gov), we provide free access to our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "1934 Act") as soon as reasonably practicable after electronic filing with the SEC. Our Code of Business Conduct and Ethics for our directors, officers and employees can be viewed on our website at [www.coatesengine.com](http://www.coatesengine.com). We will post on our website any waivers of, or amendments to, such code of ethics. Our website and the information contained therein or linked thereto are not incorporated by reference into this report.

## Background

### *Coates Spherical Rotary Valve® System Technology*

The internal combustion engine has been in use for more than 100 years and is the most widely used engine in the world. Industry sources indicate that there are more than 120 million new combustion engines built in the world every year and that 40 million engines are rebuilt annually. In the late 1960's and 1970's, most vehicle combustion engines in the United States were running at a compression ratio of 12 to 1 which resulted in an engine thermal efficiency of approximately 35 percent. The rest of the engine's power is lost in friction, pumping and heat loss. It was learned that lead additives in fuel created unacceptable health risks, therefore the lead was removed. The use of unleaded gasoline created a number of technical problems, principally related to overheating of the engine compression chamber, causing pre-ignition and resulting in damage to the engine. The problem was largely solved by lowering engine compression ratios, thereby lowering thermal efficiency from approximately 35% to approximately 22%. This loss of efficiency reduces gas mileage and engine performance. Efficiency can be improved by increasing "volumetric efficiency" at maximum RPM's, but conventional poppet valves tend to "float" or bounce at higher RPM's and are consequently unable to deliver adequate air to the cylinder. In an attempt to solve this problem, engine manufacturers increased the number of poppet valves per cylinder but this approach created other problems that cause unburned fuel to escape through the exhaust valve stems leading to a loss of power, lower gas mileage, and increased pollutants. However, variable valve timing can partially solve these additional problems, but that solution involves additional moving parts that eventually degrade and wear out. Also, variable valve timing on quick deceleration can cause piston and valve contact with resultant serious damage to the engine. Furthermore, conventional valves with solid "valve lifters" as opposed to hydraulic valve lifters must have clearances readjusted periodically. Poppet valves are the most troublesome part of the internal combustion engine. The basic inefficiencies of the conventional poppet valve design result in engine inefficiency and decreases in engine life, thermal efficiency, fuel efficiency, engine power output and increased pollution.

Conventional poppet valves also have significant environmental deficiencies. Conventional exhaust valve stems are lubricated with engine oil which burns off in the combustion chamber and is expelled through the exhaust directly into the atmosphere. Intake valves are also lubricated with engine oil, which is washed off and forced into the combustion chamber with the air and fuel mixture. This slows combustion, produces further emissions and eventually clogs the catalytic converter.

Management believes that the patented CSRV® system solves or significantly mitigates these problems. Coates rotary valves® are vented and charged on the opposite side of each valve sphere and rotate away from the combustion chamber, reducing combustion chamber constant temperature and allowing higher compression ratios that make the engine significantly more efficient and powerful.

We have successfully adapted our technology to industrial engines to power electric generators, and intend to begin to manufacture and market engines utilizing our proprietary designs operating on a multitude of fuels such as LNG, CNG, propane, flare-off gas and hydrogen.

### *Hydrogen Reactor Technology Owned by George J. Coates*

George J. Coates has developed a hydrogen reactor, which rearranges H<sub>2</sub>O water molecules into HOH molecules also known as Hydroxy-Gas. The Hydroxy-Gas produced by the hydrogen reactor is then harvested for use as a type of fuel. Mr. Coates has agreed to continue further development of this technology to enable the harvested Hydroxy-Gas to be utilized as the fuel source to power our patented CSRV® engines. This technology has been successfully applied to a small CSRV® engine which is solely powered by Hydroxy-Gas produced by the reactor from water. In addition, the Company and WTF Asia International Ltd., a Hong Kong-based entity have agreed to work together to develop this technology to enable it to be applied to large industrial gen set engines. The Company has fulfilled its obligations under this joint project by designing and integrating the switchgears, controls, load bank and emission equipment into the hydrogen reactor/gen set ("Coates Assembled Components"). On the basis of a verbal agreement, WTF Asia International Ltd. ("WTF") is currently building additional components based on technology already developed that will enable the hydrogen reactor to adequately power larger commercial and industrial engines. Upon completion of the WTF deliverable, the parties intend to enter into a formal agreement and the WTF technology will be integrated with the Coates Assembled Components resulting in a CSRV® hydrogen powered gen set.

If successful, the hydrogen reactor technology will only require a ready supply of water and would be suitable for stationary engines and generators. Conventional internal combustion engines employing poppet valve assemblies require lubrication and would experience excessive heat and friction if powered with Hydroxy-Gas. This, in turn, would cause the conventional engines to burn out in a rather short period of time. The materials and components in the more advanced design of the CSRV® engines do not require such lubrication, enabling them to operate relatively trouble-free on Hydroxy-Gas as the engine fuel. There can be no assurance that this technology can be developed successfully, or that if developed, it will be feasible to penetrate the internal combustion engine market with this technology. A number of new related patent applications are in process to protect this intellectual property. Although at this time no arrangements have been made between the Company and George J. Coates, owner of the technology, regarding licensing of the hydrogen reactor, Mr. Coates has provided his commitment to license this technology to the Company once the related patent protection is in place. Accordingly, the Company does not currently have any rights to manufacture, use, sell and distribute the hydrogen reactor technology, should it become commercially feasible to manufacture and distribute products powered by the Hydroxy-Gas fuel. The Company has been and continues to be responsible for all costs incurred related to the development of this technology.

## Markets

The design of the CSRV<sup>®</sup> system technology provides us with the flexibility to retrofit our existing internal combustion engines of all sizes and applications to appeal to a number of different geographic and product markets. In addition, the CSRV<sup>®</sup> system technology has been designed to operate effectively on a wide range of alternative fuels. Accordingly, there are no technical barriers that need to be overcome in order to strategically target economically feasible markets for products powered by internal combustion engines including, but not limited to the following: engines for electric power generators for various applications ranging from home use to the largest industrial complexes to augmented “grid” installations; engines to power motorcycles, automobiles, light trucks, heavy trucks, machinery, railroads, marine engines, military equipment, light aircraft, helicopters, lawn mowers, snowmobiles and jet skis, etc.

According to the most recent available data in a table published by the Federal Highway Administration of the U.S. Department of Transportation titled “Highway Statistics 2014,” there were total U.S. vehicle registrations for the fifty states as follows:

Automobiles	Buses	Trucks	Motorcycles	Total
113,898,845	872,027	137,162,349	8,417,718	260,350,939

## Strategy

Our long-term objective is to become a leader throughout the Americas in the design, manufacture, licensing to third party manufacturers and sales and distribution of our CSRV<sup>®</sup> internal combustion engines for a wide variety of uses. Our primary targeted market is the industrial electric power generator market. We have adapted the CSRV<sup>®</sup> system technology to manufacture our 14.0 liter inline, 6-cylinder, 855 cubic inch engine industrial generator fueled by natural gas, one of many types of Gen Sets. In parallel to penetrating the commercial/industrial generators market, we intend to adapt the CSRV<sup>®</sup> system technology to be used in other markets, in which internal combustion engines are used, such as motor vehicles, motorcycles, trucks, ships, trains, military equipment, light aircraft, helicopters and others.

## Operational Plan

### *Manufacturing, Sales and Distribution*

We have completed development of the CSRV<sup>®</sup> system technology-based generator engine and are prepared to commence the production phase of our operations, provided we raise sufficient new working capital to first produce and field test a number of additional engine generators. We intend to sell the engine generators to Almont Energy, Inc., (“Almont”) for (i) a license agreement covering the territory of Canada; and, (ii) certain rights to a license covering the territory of the United States. Almont is a privately held, independent third party entity based in Alberta, Calgary, Canada. We also intend to enter into licensing arrangements with third party manufacturers with existing industry experience and manufacturing capacity.

We intend to take advantage of the fact that essentially all the components of the CSRV<sup>®</sup> generator engine may be readily sourced and acquired from subcontractors, and, accordingly, expect to manufacture the engine generator by developing assembly lines within owned manufacturing facilities. We intend to initially commence production of Gen Sets on a small scale. This will enable us to prove our concept for the CSRV<sup>®</sup> system technology and we expect this will dovetail with the existing substantial demand in the marketplace. We plan to address this demand by establishing large scale manufacturing operations in the United States. Transitioning to large scale manufacturing is expected to require a substantial increase in our work force and substantial capital expenditures.

Our ability to establish such manufacturing operations, recruit plant workers, finance initial manufacturing inventories and fund capital expenditures is highly dependent on our ability to successfully raise substantial new working capital in an amount and at a pace which matches our business plans. Potential sources of such new working capital include sales of our equity and/or debt securities through private placement, pursuing and entering into additional sublicensing agreements with OEM's and/or distributors, positive working capital generated from sales of our CSRV<sup>®</sup> products once we raise sufficient new working capital and commence production. Although we have been successful in raising sufficient working capital to continue our ongoing operations, we have encountered very challenging credit and equity investment markets, and have not been able to raise sufficient new working capital to enable us to commence production of our CSRV<sup>®</sup> products. There can be no assurance that we will be successful in raising adequate new working capital or even any new working capital to carry out our business plans. The current economic environment, which is characterized by tight credit markets, investor uncertainty about how to safely invest funds and low investor confidence, has introduced additional risk and difficulty to our challenge to secure such additional working capital.

#### *Sublicensing*

In February 2015, we granted a non-exclusive distribution sublicense to Renown Power Development, Ltd., a China-based sales and distribution company ("Renown") covering the territory defined as the Western Hemisphere. Under this sublicense, Renown will be permitted to sell, lease and distribute CSRV<sup>®</sup> products. This sublicense provides for payment of licensing fees amounting to US\$100 million. We received an initial non-refundable deposit of \$500,000 to date. In addition, after Renown receives an aggregate of US\$10,000,000, it is required to pay us 25% of all funds it receives from any and all sources until the entire US\$100 million licensing fee is paid in full. In the event that Renown completes one or more capital raises aggregating US\$300 million or more, the then remaining unpaid balance of the US\$100 million licensing fee shall become immediately due and payable.

As collateral for payment of the sublicensing fee, Coates Power, Ltd. an independent China-based manufacturing company that will produce CSRV<sup>®</sup> products in China ("Coates Power") and Renown are to place shares of their capital stock representing a 25% ownership interest into an escrow account for the benefit of Coates International, Ltd. These shares of stock will be released from escrow and revert back to Coates Power and Renown only after the US\$100 million sublicensing fee is paid in full. We do not have an ownership interest in Coates Power or Renown. Coates Power and Renown are controlled and managed by Mr. James Pang, our liaison agent in China.

Coates Power has agreed to initially source its production parts and components from us. To date, we have agreed to manufacture and sell two gen sets to Coates Power for US\$131,000, which was paid to us in advance as a deposit.

#### **Material Agreements**

##### *License Agreement – George J. Coates and Gregory G. Coates*

We hold a license from George J. Coates and Gregory G. Coates which provides us with the right to use, manufacture, distribute, lease and sublicense the patented CSRV<sup>®</sup> system technology (the "Coates License Agreement") in the territory defined as the Western Hemisphere. Under the Coates License Agreement, we were granted an exclusive, perpetual, royalty-free, fully paid-up license to the intellectual property that specifically relates to an internal combustion engine that incorporates the CSRV<sup>®</sup> system technology (the "CSRV<sup>®</sup> Engine") and that is currently owned or controlled by them (the "CSRV<sup>®</sup> Intellectual Property"), plus any CSRV<sup>®</sup> Intellectual Property that is developed by them during their employment with us. In the event of insolvency or bankruptcy of the Company, the licensed rights would terminate and revert back to George J. Coates and Gregory G. Coates.

##### *Non-Exclusive Distribution Sublicense Agreement with Renown Power Development, Ltd.*

This material sublicense agreement, which was consummated in February 2015, is discussed in detail above under the section titled "Plan of Operations."

##### *Sublicense Agreement with Almont Energy, Inc. for the Territory of Canada*

In January 2010, we consented to the assignment of our sublicensing agreement between us and Well-to-Wire Energy, Inc. (Sublicensee") dated September 29, 1999 to Almont Energy, Inc. This sublicense agreement exclusively licenses within Canada the use of the CSRV<sup>®</sup> system technology for industrial engines fueled by natural gas to generate electrical power for the oil and gas industry (the "Canadian License"). The Canadian Sublicense provided for a license fee of \$5,000,000, of which a deposit payment in the amount of \$300,000 was made upon execution. A separate research and development agreement provided a \$5,000,000 fee payable to us in consideration for the development and delivery of certain prototype engines. We completed development of the prototypes in accordance with this agreement at the end of 2007. The research and development agreement has not been reduced to the form of a signed written agreement. To date, we have been paid a combined total of approximately \$5,153,000 by WWE and Almont under these agreements.

Additional provisions of the Canadian Sublicense agreement are as follows:

- Sublicensee shall have the exclusive right to use, lease and sell electric power generators designed with the CSRV<sup>®</sup> system technology within Canada.
- Sublicensee will have a specified right of first refusal to market the electric power generators worldwide.
- Upon commencement of the production and distribution of the electric power generators, the minimum annual number of generators to be purchased by Sublicensee in order to maintain exclusivity is 120. Until otherwise agreed between the parties, the price per generator shall be \$159,000. We have agreed to pass along to Almont savings we expect to realize from economies of scale inherent in high volume production of the CSRV<sup>®</sup> units. In the event Sublicensee fails to purchase the minimum 120 Coates generator engines during any year, Sublicensee will automatically lose its exclusivity. In such case, Sublicensee would retain non-exclusive rights to continue to use and sell the CSRV<sup>®</sup> generator engine in the territory of Canada. We have temporarily suspended this provision due to the delay in delivery of Gen Sets.
- Sublicensee is required to pay a royalty to us equal to 5% of its annual modified gross profit (which has been defined as sales, less cost of sales, plus \$400,000).
- All licensed rights under this sublicense agreement related to the CSRV<sup>®</sup> system technology will remain with the Company.

We have also consented to the assignment of the rights to a conditional sublicensing agreement with WWE covering the territory of the United States of America (the "US License") to Almont. The US License provides for a license fee of \$50 million and annual minimum purchases of CSRV<sup>®</sup> Units as a condition of exclusivity. The US license has been deposited into an escrow account and the grant of the license is not effective until the conditions for release from escrow are satisfied.

The escrow agreement was established to provide a more secure mechanism for us to collect payments due under both the prior Canadian sublicensing and research and development agreements and the \$50 million US License (the "Escrow Agreement"). The Escrow Agreement provides that the US License shall be held until we receive a release payment (the "Release Payment"). The Release Payment consists of (i) an initial down payment required under the US License of \$1 million and (ii) an \$8.5 million payment of the balance of the monies due to us at the date of the Escrow Agreement, in connection with the sublicense for the territory of Canada, including the Canadian License Agreement and the research and development agreement (the "Canadian Agreements"). While the US License is held in escrow, there shall not be any grant of license. The first \$3.8 million of the Release Payment, which has been designated as payment of the fees due under the research and development agreement, is being recognized as revenue at the time the cash payments are received. We have received approximately \$3.65 million of the Release Payment to date. In addition, WWE had made nonrefundable payments to us totaling \$1.5 million prior to establishment of the Escrow Agreement. Upon full satisfaction of the Release Payment, Almont would be granted a sublicense for the territory of the United States under the US License agreement.

The remaining balance of the Release Payment is approximately \$5,847,000. It is unlikely that Almont will be able to make further payments of the Release Payment until we raise sufficient new working capital to commence manufacturing operations and shipping of Gen Sets.

In connection with the assignment of the Canadian and US License from WWE to Almont, we previously extended the date by which the entire Release Payment must be paid, until March 2014 to compensate for the delayed delivery of Gen Sets. The Release Payment due date is expected to be reset as appropriate once the Company commences its production phase of operations. Almont is required to remit to us 60% of any and all proceeds from funds raised from any equity, debt or lending transactions, exclusive of equipment financing transactions, until the Release Payment is paid in full.



The US License would, if Almont is able to satisfy the Escrow Agreement release provisions, grant to Almont the right to use, sell and lease Licensed Products manufactured by us as the power source for the generation of electrical energy for the oil and gas industry and landfills. Licensed Products consist of CSRV® Valve Systems, CSRV® Valve Seals, CSRV® Rotary Valve Spheres, CSRV® Valve Components and CSRV® Engines. Almont is also obligated to pay a royalty to us equal to 2.5% of its annual modified gross profit (which has been defined as sales, less cost of sales, plus \$400,000).

The manufacture of our licensed products by Almont is prohibited. Almont is required to procure all internal combustion engines incorporating the CSRV® system technology from us or our designee. The license granted to Almont is exclusive within the defined territory, provided that Almont satisfies the minimum annual purchase commitment of 120 internal combustion engines incorporating the CSRV® system technology. The agreement also grants Almont a right of first refusal in the event that we negotiate an offer with another third party for a worldwide license to use the licensed product in the oil and gas industry and landfill operations.

After payment of the Release Payment which includes a \$1 million deposit on the US License, the remaining \$49 million balance of the US License fee is payable in quarterly installments in an amount equal to 5% of Almont's prior quarter net profits. The entire balance of the licensing fee was to be paid in full on or before February 19, 2016. In order to compensate for the delayed delivery of Gen Sets, this date is expected to be reset as appropriate once the Company commences its production phase of operations.

Acceleration of the payment of the balance of the licensing fee shall be required in the event that Almont completes a stock offering or private placement offering. The entire unpaid balance of the licensing fee shall become due and payable if Almont raises \$100 million or more from such offerings.

#### *Equity Purchase and Registration Rights Agreement*

In July 2014, the Company entered into an equity purchase agreement (the "2014 EP Agreement") with Southridge Partners II LP, a Delaware limited partnership ("Southridge"). Pursuant to the terms of the 2014 EP Agreement, Southridge committed to purchase up to 40,000,000 shares of the Company's common stock, in exchange for consideration not to exceed Ten Million (\$10,000,000) Dollars. In June 2015, the 2014 Agreement automatically terminated because Southridge had purchased all 40,000,000 shares of common stock permitted under the 2014 EP Agreement. Accordingly, on July 29, 2015, the Company entered into a new 3-year equity purchase agreement (the "2015 EP Agreement") with Southridge. Pursuant to the terms of the 2015 EP Agreement, Southridge committed to purchase up to 205,000,000 shares of the Company's common stock, in exchange for consideration not to exceed Twenty Million (\$20,000,000) Dollars on the same terms and conditions as the 2014 EP Agreement.

The terms of the 2014 and 2015 EP Agreements provided that the purchase price for the shares of common stock shall be equal to 94% of the lowest closing price of the common stock during the ten trading days that comprise the defined pricing period. The Company is entitled to exercise a Put to Southridge by delivering a Put Notice, which requires Southridge to remit the dollar amount stated in the Put Notice at the end of the pricing period, provided, however, that for each day during the pricing period, if any, that the daily closing price of the Company's common stock is (i) 25% or more below the Floor Price, as defined, or (ii) below the Floor Price, if any, stipulated in the Put Notice issued by the Company, then the dollar amount of the Put shall be reduced by 10% for each such day. The Company may stipulate a Floor Price below which, no shares of common stock may be sold by Southridge, however, the Floor price shall not be lower than the lowest daily volume weighted average price of the common stock during the ten trading days preceding the date of the Put Notice.

During the year ended December 31, 2015, the Company (i) sold all of the 40,000,000 registered shares of common stock to Southridge and received proceeds of \$207,000, thereby resulting in the termination of this 2014 EP Agreement, and (ii) sold 35,505,910 registered shares of common stock to Southridge and received proceeds of \$200,000 under the 2015 EP Agreement.

As of December 31, 2014, no Put Notices had been delivered to Southridge under the EP Agreement.

## **Competition**

Management believes that the Coates Engine<sup>®</sup> generators which are based on the CSR<sup>®</sup> system technology will provide substantially enhanced efficiencies in power generation and longevity. We believe that the Coates Engines<sup>®</sup> will outperform other comparable natural gas-fueled electric generator engines currently utilized in the energy conversion market.

Notwithstanding our perceived competitive advantages, the power generation market is a highly competitive industry currently occupied by extremely large companies such as Caterpillar, Inc., which owns MAK, Perkins and FG Wilson, Detroit Diesel Corporation, AB Volvo, Cummins and Marathon, among others. These companies have far greater financial and other resources than we do and already occupy segments of the power generation market. In order to successfully penetrate this industry, the Coates Engines<sup>®</sup> will have to produce the performance and durability results anticipated by management and sell at a price or prices that will enable it to effectively compete and gain entrance into this market.

## **Parts and Supplies**

To date, management has utilized the services of various vendors and suppliers available throughout the United States to provide all of the parts necessary to produce the Coates Engines<sup>®</sup>. We intend to continue to purchase all of our raw materials and parts, manufactured to our specifications, from a wide assortment of suppliers. We have signed a letter of intent with Marathon Electric Manufacturing Corp. for the supply of generators and components. We also entered into an agreement with Cummins Power Systems (a business owned by Cummins Inc.) to supply industrial engine blocks and components to us for our manufacturing activities. We intend to initially commence the assembly of the Coates Engines<sup>®</sup> at our existing New Jersey facility and to subsequently acquire additional facilities to increase our manufacturing capacity, as needed.

## **Licenses and Patents**

The Coates License Agreement grants us an exclusive, perpetual, royalty-free, fully paid-up license in the territory of North, Central and South America, to use all intellectual property rights that are currently owned or controlled by the licensors that directly relate to an internal combustion engine that includes the CSR<sup>®</sup> system technology. The license also covers any new or improved technology and related intellectual property rights that are directly related to the CSR<sup>®</sup> Engine system technology developed by the licensors during their employment with us.

Included in the license are intellectual property rights for 17 patents registered in the United States; certain patents registered in Canada, Mexico, in countries in Central and South America relating to the CSR<sup>®</sup> system technology; and one U.S. patent application filed by Mr. George J. Coates. These patents are owned by George J. Coates and Gregory G. Coates. Under our license agreement, we are obligated to pay for all costs relating to the ongoing maintenance of the patents.

We rely upon patents, trade secrets, know-how and continuing technological innovation to develop and maintain our competitive position. We can provide no assurance that we can successfully limit unauthorized or wrongful disclosures of trade secrets or otherwise confidential information. In addition, to the extent we rely on trade secrets and know-how to maintain our competitive technological position, there can be no assurance that others might not independently develop the same, similar or superior techniques.

We have also granted sublicenses to Renown Power Development, Ltd. and Almont Energy, Inc. as discussed in more detail under the section titled "Plan of Operations."

## **Environmental Regulatory Compliance**

All of our engines, including the Coates Engine<sup>®</sup>, will be subject to extensive environmental laws, rules and regulations that impose standards for emissions and noise. Initially, compliance with the emissions standards promulgated by the U.S. Environmental Protection Agency ("EPA"), as well as those imposed by the State of New Jersey and other jurisdictions where we expect our engines will be used, will have to be achieved in order to successfully market the Coates Engine<sup>®</sup>. When selling individual engines, we are not subject to the governmental standards as set forth in 40CFR (Code of Federal Regulations) 1048, which regulates environmental standards for natural gas-powered industrial engines. In this case, the purchaser or sublicensee becomes responsible for complying with applicable governmental standards in its territory. We believe that our natural gas powered engine/generators comply with governmental standards as set forth in 40CFR (Code of Federal Regulations) 1048, that regulates environmental standards for natural gas-powered industrial engines. Our ability to comply with applicable and future emissions standards is necessary for us to enter and continue to operate in the power generation and other markets. Failure to comply with these standards could result in a material adverse effect on our business and financial condition.

## Employees

At December 31, 2015, we had 5 employees, including George J. Coates and his son Gregory G. Coates, who perform management, assembly and research and development functions. Bernadette Coates, the spouse of George J. Coates, is employed as an administrative manager for the Company.

## Item 1A. Risk Factors

### Risk Factors Relating to Our Financial Condition:

#### **Our Independent Registered Public Accountants have expressed substantial doubt about our ability to continue as a going concern.**

As shown in the accompanying financial statements, we have incurred recurring losses from operations of (\$56,971,000); and, as of December 31, 2015 had a stockholders' deficiency of (\$5,299,000) and negative working capital of (\$5,476,000). The current economic environment, which is characterized by tight credit markets, investor uncertainty about how to safely invest their funds and low investor confidence, has introduced additional risk and difficulty to the Company's challenge to secure needed additional working capital. These factors raise substantial doubt about our ability to continue as a going concern within one year after the date of filing of this annual report on Form 10-K. Our Independent Registered Public Accountants have stated in their Auditor's Report dated April 14, 2016 with respect to our financial statements as of and for the year ended December 31, 2015 that these circumstances raise substantial doubt about our ability to continue as a going concern. The financial statements do not include any adjustments that might be necessary should we become unable to continue as a going concern.

The substantial doubt about our ability to continue as a going concern has been reported, as required by generally accepted accounting principles, since 1995. In spite of this continuing doubt, we have developed a long history of meeting our obligations as they come due, year after year. During the year ended December 31, 2015, we met our obligations as they became due by raising additional working capital of \$1,108,000 of new working capital from issuances of convertible promissory notes, sales of registered shares common stock under equity purchase agreements and issuances of promissory notes to related parties.

Although there can be no assurance that we will be able to overcome this doubt in the future, our management believes that we can continue to meet our obligations as they come due in consideration of the following:

- We are manufacturing a small number of production-quality Gen Sets for sales and installation with end users. In addition, patterns for engine heads and permanent molds for spherical rotary valves have already been modified by vendors for production purposes. These are the initial steps towards moving the Company into ongoing manufacturing and distribution operations for our CSRV® Gen Sets. If successful, this will represent a new source of cash flow and working capital for us.
- In addition, we expect to continue to raise working capital from a number of sources to meet our ongoing obligations as they become due. These sources include deposits on sublicense agreements such as the new sublicense agreement with a China-based entity, sales of common stock and warrants, proceeds from issuances of convertible notes, sales of common stock under an equity purchase agreement with Southridge and proceeds from promissory notes issued to related parties.
- Finally, management has instituted a cost control program intended to restrict variable costs requiring an outlay of cash to only those expenses that are necessary to carry out our activities related to research and development activities, entering the production phase of operations, developing additional commercially feasible applications of the CSRV® system technology, seeking additional sources of working capital and covering general and administrative costs in support of such activities.

**We have significant immediate capital needs and our ability to raise funds on terms acceptable to us is highly uncertain.**

We will need additional working capital from equity and/or financing transactions in the near future for a number of uses, including:

- Ongoing general and administrative expenses
- Purchasing raw material inventory and hiring plant workers to commence our production phase.
- Expanding manufacturing capacity.
- Developing an expanded management team to oversee the expanded scope of our operating activities upon commencement of production.
- Developing our engineering, administrative and marketing and sales organizations.
- Expanding our research and development programs with respect to the CSRV<sup>®</sup> system technology and applying the CSRV<sup>®</sup> system technology to engines used in various commercially viable applications.
- Implementation of new systems, processes and procedures to support growth.

Additional sources of working capital may not be available on terms acceptable to us, or may not be available at all.

As with any business, many aspects of our operations and our future outlook are subject to events and influences which are not within our control, such as the continuing sluggish worldwide economy. This could have an adverse impact on us and our results of operations. For example:

- The current severe limitation on the availability of credit and investor uncertainty could result in delays or the inability to acquire additional working capital needed to commence an efficient level of production. Commencing production and shipments to Almont are a vital factor in Almont's ability to remit further payments toward the Release Payment.
- Demand for our technology and products could be significantly reduced.
- Estimates used in the preparation of our financial statements may need to be revised.

**Risk Factors Relating to Our Product Development:**

**Limited production and sales of CSRV<sup>®</sup> engine generators.**

To date, we have only had sales of two CSRV<sup>®</sup> engine generators for \$284,000 and received limited revenues from our research and development agreement with WWE. A number of years ago, we also received limited revenues from a small number of sales of engines, which incorporated the CSRV<sup>®</sup> system technology. We have not been able to move into the CSRV<sup>®</sup> engine generator production phase of our business because we have not been successful in raising sufficient new working capital.

We expect to continue to incur losses until we commence production and distribution of products incorporating our CSRV<sup>®</sup> system technology. We may not be profitable or operating cash flow positive in 2016 unless we can begin to generate positive cash flows from sales of CSRV<sup>®</sup> Engine products or receive cash proceeds from new licensing agreements for our CSRV<sup>®</sup> system technology. In addition, we may not be profitable or operating cash flow positive for several additional years after 2016.

**The Coates CSRV<sup>®</sup> System Technology may not have the performance characteristics and longevity that we expect which may adversely affect our future revenues.**

The Coates Engine<sup>®</sup> has only been tested to a very limited degree in a "real world" environment. Commercial use of our industrial engines may not have the performance characteristics that we expect. Similarly, until the Coates Engine<sup>®</sup> has been in use for a substantial period of time, there is no certain way to ascertain its expected longevity. Superior performance and longevity are essential elements of our ability to penetrate the power generation and other markets. Our failure to do so would have a material adverse effect on our business and, unless remedied on a timely basis we might be forced to close our operations.

**Risk Factors Relating to Our Business:****Our Success Depends to a Large Extent on Our Founder George J. Coates and His Son Gregory G. Coates, the Loss of Either of Whom Could Disrupt Our Business Operations.**

Our future success will depend in substantial part on the continued services of George J. Coates and, to a lesser extent, Gregory G. Coates. The loss of the services of George J. Coates and/or Gregory G. Coates could impede implementation of our business plan and reduce our opportunity for profitability. We expect that our future market capitalization will be highly dependent on the productivity of George J. Coates. If the employment of George J. Coates was to cease for any reason before we have hired additional senior management and engineering personnel, our business would be materially adversely affected and we may have to discontinue operations. We do not have employment agreements in place with George J. Coates and Gregory G. Coates. Although George J. Coates is our majority shareholder and Gregory G. Coates is a major shareholder of the Company, a risk exists that they could voluntarily terminate their employment with us at any time and for any reason. In such case, either or both of them could establish one or more new businesses that might compete with ours. We do not maintain key person insurance on either George J. Coates or Gregory G. Coates.

**We may encounter substantial competition in our business and our failure to compete may adversely affect our ability to generate revenue.**

The power generation market is a highly competitive industry currently occupied by extremely large companies. These companies have far greater financial and other resources than we do and already occupy segments of the power generation market. In order to successfully penetrate this industry, the Coates Engine<sup>®</sup> will have to produce the performance and durability results anticipated by management and sell at a price or prices that will enable it to effectively compete and gain entrance into this market.

**Our Dependence on Third Party Suppliers for Key Components of Our Products Could Delay Shipment of Our Products and Reduce Our Sales.**

We depend on certain domestic suppliers for the delivery of components used in the assembly of our products. Our reliance on third-party suppliers creates risks related to our potential inability to obtain an adequate supply of components or subassemblies and reduced control over pricing and timing of delivery of components and sub-assemblies. Specifically, we depend on suppliers of short engine blocks, custom pistons, custom spherical rotary valves, valve seals, carriers, springs, value added services and other miscellaneous components and parts for our products. Any interruption of supply for any material components of our products could significantly delay the shipment of our products and have a material adverse effect on our revenues, profitability and financial condition.

**Our short term business success relies to some extent upon our United States and Canadian licensing and research and development agreements which have been assigned to Almont.**

The initial monies due under the United States and Canadian licensing agreements and the research and development agreement assigned to Almont represent potential new sources of cash due to us totaling approximately \$5.85 million. To date, we have received nonrefundable payments for the licensing and research and development agreements aggregating approximately \$5,153,000. The likelihood of Almont making further payments to us under the Escrow Agreement is completely dependent on our ability to produce and ship additional engines to Almont. During the period until Almont is able to make additional payments to us, our cash flow, results of operations and financial condition are being adversely affected.

**We may be subject to claims with respect to the infringement of intellectual property rights of others, which could result in substantial costs and diversion of our financial and management resources to defend such claims and/or lawsuits and could harm our business.**

We cannot be certain that our licensed rights to the patented engine designs and technologies will not infringe upon patents, copyrights or other intellectual property rights held by third parties. While we know of no basis for any claims of this type, the existence of and ownership of intellectual property can be difficult to verify and we have not made an exhaustive search of all patent filings. Additionally, most patent applications are kept confidential for twelve to eighteen months, or longer, and we would not be able to be aware of potentially conflicting claims that they make. We may become subject to legal proceedings and claims from time-to-time relating to the intellectual property of others in the ordinary course of our business. If we are found to have violated the intellectual property rights of others, we may be enjoined from using such intellectual property, and we may incur licensing fees or be forced to develop alternative technology or obtain other licenses. In addition, we may incur substantial expenses in defending against any third party infringement claims and be diverted from devoting time to our business and operational issues, regardless of the merits of any such claim. Successful infringement or licensing claims against us may result in substantial monetary damages, which may materially disrupt the conduct of our business and have a material adverse effect on our reputation, business, financial condition and results of operations.

**Our success is dependent on protecting our intellectual property rights.**

We rely on a combination of patent, copyright, trademark and trade secret protections to protect our rights under our license to the proprietary technology. We cannot assure you that these trademarks and patents will not be challenged, invalidated, or circumvented, or that the rights granted under those registrations will provide competitive advantages to us.

In addition, there is currently no understanding in place regarding the ownership of new intellectual property not directly related to the CSRV<sup>®</sup> system technology, developed by either George J. Coates or Gregory G. Coates while employed by us. As a result, there is a risk that we may not derive any benefit from such newly developed intellectual property.

**In the event of insolvency or bankruptcy, the intellectual property rights licensed to us would automatically revert back to George J. Coates and Gregory G. Coates.**

Under our license agreement for the CSRV<sup>®</sup> system technology, in the event of insolvency or bankruptcy, our intellectual property rights and our rights to license the intellectual property would automatically revert back to George J. Coates and Gregory G. Coates. This would result in a lower potential recovery of investment by, and/or liquidation value to, our stockholders.

**We have very limited marketing and sales experience.**

We have no marketing or sales experience. The sales process is expected to be lengthy, in part because of skepticism about the performance of the Coates Engine<sup>®</sup>. We are evaluating alternative marketing and sales channels, distributors, sublicensees and marketing partners. We may never successfully market and sell the Coates Engine<sup>®</sup>.

**We have only a token number of employees, and in order to grow our business we will need to hire significant additional personnel.**

We need to hire, train and retain additional employees for all aspects of our business if we are to achieve our production and sales goals. Our success will also depend on our ability to attract and retain a staff of qualified managerial, engineering and manufacturing plant workers. Qualified individuals are in high demand and are often subject to competing offers. We cannot be certain that we will be able to attract and retain the qualified personnel we need for our business. If we are unable to hire additional personnel as needed, it would have a material adverse effect on our business and operations. In particular, we need trained engineers and sales personnel to educate potential customers and provide post-installation customer support.

**As a publicly reporting company, we incur substantial expenses to comply with the reporting requirements which could have a detrimental effect on our business and finances, the value of our stock and the ability of stockholders to resell their stock.**

Since we are subject to the information and reporting requirements pursuant to Section 15(d) of the Exchange Act, as well as other disclosure requirements such as the proxy rules, going private rules and many tender offer provisions, our stockholders will not have access to the short-swing reporting and profit receiving protections or information that is provided by beneficial ownership reporting requirements of the U.S. securities laws. Additional SEC regulations already in place have also substantially increased the accounting, legal, and other costs related to becoming and remaining an SEC publicly reporting company. In the current regulatory environment, a recent trend has been established to continue to introduce substantial additional regulations affecting financial markets and publicly reporting companies. There can be no assurance that new regulations introduced in the future, will not significantly increase the cost of compliance for publicly traded companies. If we do not meet the public company reporting requirements designed to make current information about our company available to market makers, they will not be able to trade our stock. In addition, if we do not comply with the public company reporting requirements, we will be in default of our convertible promissory notes, which provide for substantial penalties in such event and would likely have a material adverse effect on our financial condition and results of operations. The public company costs of preparing and filing annual and quarterly reports, and other information with the SEC and furnishing audited reports to stockholders, cause our expenses to be higher than they would be if we were privately-held and not subject to public company reporting regulatory requirements. In addition, we may incur substantial expenses in connection with the preparation of registration statements required to be filed in connection with the registration of securities under the Securities Act of 1933. These increased costs may be material and may include the hiring of additional employees and/or the retention of additional advisors and professionals. Our failure to comply with federal securities laws could result in private or governmental legal action against us and/or our officers and directors, which could have a detrimental effect on our business and finances, the value of our stock, and the ability of stockholders to resell their stock.

**We may be exposed to potential risks, penalties and expenses resulting from the Sarbanes Oxley Act of 2002.**

In addition to the costs of compliance with having our shares of common stock listed on the OTC Pink Sheets, there are substantial penalties that could be imposed upon us if we fail to comply with all regulatory requirements. In particular, under the Sarbanes-Oxley Act of 2002 we are required to include in our annual report our assessment of the effectiveness of our internal control over financial reporting as of the end of our fiscal year.

**We may become subject to product liability and/or warranty claims, which could harm our financial condition and liquidity if we are not able to successfully defend or insure against such claims.**

We do not currently maintain product liability insurance for our CSRV<sup>®</sup> products. We intend to make a proper assessment of the product liability risk related to our products and we may apply for product liability insurance, to the extent believed necessary in the future and at the time that our working capital is sufficient for this purpose. Any lawsuit seeking significant monetary damages may have a material adverse effect on our business and financial condition. We may not be able to secure product liability insurance coverage on commercially acceptable terms or at reasonable costs when needed, particularly if we do face liability for our products and are forced to make a claim under our policy. In addition, a product liability claim could generate substantial negative publicity about our CSRV<sup>®</sup> products and business, and inhibit or prevent commercialization of other future CSRV<sup>®</sup> products, which would have a material adverse effect on our brand, business, prospects, financial condition and operating results.

While our products are tested for quality, our products nevertheless may fail to meet customer expectations from time-to-time. Also, not all defects are immediately detectible. Failures could result from faulty design or problems in manufacturing. In either case, we could incur significant costs to repair and/or replace defective products under warranty. Liability claims could require us to spend significant time and money in litigation and pay significant damages. As a result, any of these claims, whether or not valid or successfully prosecuted, could have a substantial, adverse effect on our business and financial results. In addition, although we plan on putting product liability insurance in place, the amount of damages awarded against us in such a lawsuit may exceed the policy limits of such insurance. Further, in some cases, product redesigns and/or rework may be required to correct a defect and such occurrences could adversely impact future business with affected customers. Our business, financial condition, results of operations and liquidity could be materially and adversely affected by any unexpected significant warranty costs.

## **Risk Factors Relating to Our Common Stock:**

**Our common stock is thinly traded, so you may be unable to sell at or near ask prices or at all if you need to sell your shares to raise money or otherwise desire to liquidate your shares.**

Our common stock has historically been sporadically or “thinly-traded” on the OTC Pink Sheets, meaning that the number of persons interested in purchasing our common stock at or near ask prices at any given time may be relatively small or nonexistent. This situation is attributable to a number of factors, including the fact that we are a small company which is relatively unknown to stock analysts, stock brokers, institutional investors and others in the investment community that generate or influence sales volume, and that even if we came to the attention of such persons, they tend to be risk-averse and would be reluctant to follow an unproven company such as ours or purchase or recommend the purchase of our shares until such time as we became more seasoned and viable. In addition, due to the current trading price range of our common stock many broker/dealers will not agree to honor sell orders or clear trades in our common stock. In this case, shareholders may be required to open a new brokerage account with one of the broker/dealers that is willing to honor sell orders in our common stock. There can be no assurance that such a broker/dealer would not impose higher commission rates on such sell orders than might be customary for more actively traded stocks trading in higher price ranges. It is also possible that the number of buyers in the market for our common stock could be reduced if a potential investor expects that the effort to sell shares of our common stock is too cumbersome.

As a consequence, there may be periods of several days or more when trading activity in our shares is minimal or non-existent, as compared to a mature issuer which has a large and steady volume of trading activity that will generally support continuous sales without an adverse effect on share price. It is possible that a broader or more active public trading market for our common stock will not develop or be sustained, or that current trading levels will continue.

**Because we do not intend to pay dividends for the foreseeable future, stockholders will only benefit from an investment in our common stock if it appreciates in value.**

We have never declared any dividends and our board of directors does not intend to declare and distribute dividends in the near future. The declaration, payment and amount of any future dividends will be made at the discretion of the board of directors and will depend upon, among other things, the results of our operations, cash flows, financial condition, operating and capital requirements, and other factors as the board of directors considers relevant. There is no assurance that future dividends will be paid, and, if dividends are paid, there is no assurance with respect to the amount of any such dividends. We currently intend to retain our future earnings, if any, to finance further research and development, commence production of the Coates Engine<sup>®</sup> and pay for our general and administrative expenses. As a result, the success of an investment in our common stock will depend upon any future appreciation in its value. There is no assurance that our common stock will appreciate in value or even maintain the price at which stockholders have purchased their shares.

**Because we will be subject to the “penny stock” rules if the shares are quoted on the OTC Pink Sheets, the level of trading activity in the shares may be reduced and shareholders may be unable to sell their shares.**

The SEC has adopted regulations which generally define a “penny stock” to be any equity security that has a market price of less than \$5.00 per share or an exercise price of less than \$5.00 per share, subject to certain exceptions. Our securities will likely be covered by the penny stock rules, which impose additional sales practice requirements on broker-dealers who sell to persons other than established customers and accredited investors. The penny stock rules require a broker-dealer, prior to a transaction in a penny stock not otherwise exempt from the rules, to deliver a standardized risk disclosure document in a form prepared by the SEC that provides information about penny stocks and the nature and level of risks in the penny stock market. The broker-dealer also must provide the customer with current bid and other quotations for the penny stock, the compensation of the broker-dealer and its salesperson in the transaction and monthly account statements showing the market value of each penny stock held in the customer’s account. The bid and offer quotations, and the broker-dealer and salesperson compensation information, must be given to the customer orally or in writing prior to effecting the transaction and must be given to the customer in writing before or with the customer’s confirmation. In addition, the penny stock rules require that prior to executing a transaction in a penny stock not otherwise exempt from these rules; the broker-dealer must make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser’s written agreement to the transaction. These disclosure and suitability requirements may have the effect of reducing the level of trading activity in the secondary market for a stock that is subject to these penny stock rules. Consequently, these penny stock rules may affect the ability of broker-dealers to trade our securities. We believe that the penny stock rules discourage investor interest in, and limit the marketability of, our capital stock. Trading of our capital stock may be restricted by the SEC’s “penny stock” regulations which may limit a stockholder’s ability to buy and sell our stock.



**George J. Coates and his family own a majority of our common stock allowing them to unilaterally determine the outcome of all matters submitted to our stockholders for approval, which influence may or may not conflict with our interests and the interests of our other stockholders.**

George J. Coates, together with members of his family and related trusts, are beneficially entitled to approximately 87% of votes on matters submitted to a vote of the outstanding common stockholders at April 8, 2016 and will therefore be able to unilaterally determine the outcome of all matters submitted to our stockholders for approval, including the election of our directors and other corporate actions. There can be no assurance that the votes of George J. Coates and his family on matters submitted to a vote by our shareholders in the future will not conflict with our interests and the interest of our other shareholders.

**You may be unable to sell your common stock at or above your purchase price, which may result in substantial losses to you.**

The following factors may add to the volatility in the price of our common stock: actual or anticipated variations in our quarterly or annual operating results; government regulations, announcements of significant acquisitions, strategic partnerships or joint ventures; our capital commitments; and additions or departures of our key personnel. Many of these factors are beyond our control and may decrease the market price of our common stock, regardless of our operating performance. We cannot make any predictions or projections as to what the prevailing market price for our common stock will be at any time, including as to whether our common stock will sustain its current market price, or as to what effect that the sale of shares or the availability of common stock for sale at any time will have on the prevailing market price.

**Trading in our common stock may be volatile, which may result in substantial declines in its market price.**

Our common stock is likely to experience significant volatility in response to periodic variations in:

- Our success in commencing our production phase of operations.
- Results of testing of the CSR<sup>V</sup>® system technology as it is designed and adapted for various commercially feasible applications.
- Our prospects for entering into new potentially profitable license agreements for our technology.
- Performance of the CSR<sup>V</sup>® system technology in the field.
- Improvements in engine technology by our competitors.
- Changes in general conditions in the economy or the financial markets.

The market may also experience significant volatility which can affect the market prices of securities issued by many companies; often for reasons unrelated to their operating performance, and may adversely affect the price of our common stock. The market for our common stock is limited. We cannot assure that an active trading market can be maintained. In such case, our stockholders may find it difficult to dispose of shares of our common stock and, as a result, may suffer a loss of all or a substantial portion of their investment.

**We have 134,874,602 remaining registered shares of common stock that could be issued under an equity purchase agreement with Southridge Partners II LP. The sale of such shares could depress the market price of our common stock.**

We have 134,874,602 remaining registered shares of common stock under a registration statement covering shares of our common stock that may be issued under an equity purchase agreement with Southridge Partners II LP (“Southridge”). Sales of such shares into the public market by Southridge will dilute the ownership interest and share of any dividends declared by the Company and could depress the market price of our common stock.

**Our issuance of additional common stock in exchange for services or to repay debt would dilute your proportionate ownership and voting rights and could have a negative impact on the market price of our common stock.**

Our board of directors may, from time to time, approve the issuance of shares of common stock to pay for debt or services, without further approval by our stockholders based upon such factors as our board may deem relevant at that time. As of April 8, 2016, we had approximately \$387,000 face amount of convertible debt outstanding. This debt, if not prepaid within 180 days after the date of the convertible note, is convertible into shares of our common stock at a 30% to 40% discount from the contractually defined trading price of our stock over a defined stock price measurement period which precedes the date of conversion. It is possible that we will issue additional securities to pay for services and reduce debt in the future.

**Anti-dilution protection for George J. Coates, Gregory G. Coates and Barry C. Kaye, stock awards to our officers and directors and exercise of stock options will cause additional shares of our common stock to be issued which will dilute the ownership interest and share of dividends of existing shareholders.**

We have granted stock options to officers, directors, consultants and advisers, which may be exercised and converted into shares of our common stock. In addition, we grant stock awards and provide for anti-dilution protection to key officers and directors which may be in the form of shares of common stock or instruments convertible into shares of common stock, including Series B Convertible Preferred Stock. At April 8, 2016, 1,273,187 shares of Series B Convertible Preferred Stock issued to key officers, which are also directors, each of which is convertible into 1,000 shares of common stock on the 2<sup>nd</sup> anniversary date after issuance, were issued and outstanding. The occurrence of these events will dilute the ownership interest and share of any dividends declared by the Company and could depress the market price of our common stock.

**Item 1B. Unresolved Staff Comments.**

Smaller reporting companies are not required to provide the information required by this item.

**Item 2. Properties.**

We own our executive offices and research and development facility, which is located in an approximately 29,000 square foot building on approximately 7 acres in Wall Township, New Jersey, approximately 60 miles outside of New York City.

In our research and development operations, we own and utilize milling machines, lathes, grinders, hydraulic lifts and presses, tooling, a dynamometer, emission testing machines and computerized drafting and printing equipment. All such equipment is in good condition.

**Item 3. Legal Proceedings.**

We are currently not involved in any litigation that we believe could have a materially adverse effect on our financial condition or results of operations. There is no action, suit, proceeding, inquiry or investigation before or by any court, public board, government agency, self-regulatory organization or body pending or, to the knowledge of the executive officers of our company or any of our subsidiaries, threatened against or affecting our company, our common stock, any of our subsidiaries or of our company's or our company's subsidiaries' officers or directors in their capacities as such, in which an adverse decision could have a material adverse effect.

**Item 4. Mine Safety Disclosure.**

Not applicable.

## PART II

### Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

#### Market

Our common stock is traded on the OTC Pink Sheets under the ticker symbol COTE. The closing price of the common stock on April 8, 2016 was \$0.0018 per share. The high and low closing bid prices for trading of our stock for each of the quarters during 2015 and 2014 are as follows:

	<u>1<sup>st</sup> Quarter</u>	<u>2<sup>nd</sup> Quarter</u>	<u>3<sup>rd</sup> Quarter</u>	<u>4<sup>th</sup> Quarter</u>
2015:				
High	\$ 0.0140	\$ 0.0600	\$ 0.0195	\$ 0.0075
Low	\$ 0.0020	\$ 0.0010	\$ 0.0032	\$ 0.0024
2014:				
High	\$ 0.0600	\$ 0.0500	\$ 0.0398	\$ 0.0300
Low	\$ 0.0310	\$ 0.0220	\$ 0.0251	\$ 0.0070

In March 2015, the majority stockholder authorized the board of directors to declare at some indefinite point in the future, a reverse stock split at such time as the board of directors determines, in its sole discretion, is appropriate based on market conditions and the Company's financial condition, results of operations and financial prospects. The Board may select a conversion ratio which shall be in the range of from (a) one new post-split share of common stock for 5 old pre-split shares of common stock (a 1:5 ratio) to (b) one new post-split share of common stock for 200 old pre-split shares of common stock (a 1:200 ratio). The wide range of ratios was established to provide maximum flexibility, so that the board would not be limited in choosing a ratio that was in the best interest of the company and its shareholders in the event that a reverse stock split is ever declared. The Board is under no obligation to actually declare a reverse stock split and may never act on this authorization, unless it first properly considers all conditions and factors and concludes that it is appropriate to do so. This authorization will continue in force until revoked by a corporate action consented to by the majority stockholder or by a vote of the stockholders.

#### Holdings

At April 13, 2016, the number of holders of record of our common stock was 736. Because shares of our common stock are held by depositaries, brokers and other nominees, the number of beneficial holders of our shares is substantially larger than the number of stockholders of record.

#### Recent Sales of Unregistered Securities

*The following issuances of securities during the the year ended December 31, 2015 were exempt from registration pursuant to Section 4(2), and Regulation D promulgated under the Securities Act. We made this determination based on the representations of the Investors which included, in pertinent part, that such Investors were "accredited investors" within the meaning of Rule 501 of Regulation D promulgated under the Securities Act, and that such Investors were acquiring our common stock, for investment purposes for their own respective accounts and not as nominees or agents, and not with a view to the resale or distribution thereof, and that the Investors understood that the shares of our common stock may not be sold or otherwise disposed of without registration under the Securities Act or an applicable exemption therefrom.*

In a series of transactions, an aggregate of \$974,000 principal amount of convertible promissory notes, including accrued interest was converted by the holders into 520,777,116 unregistered shares of our common stock.

For the year ended December 31, 2015, 2,708,430, 184,382 and 14,435 shares of Series B were issued to George J. Coates, Gregory G. Coates and Barry C. Kaye, respectively, having an estimated fair value of \$7,497,000, \$506,000 and \$40,000, respectively.

#### Dividends

We have never declared or paid any cash dividends on shares of our common or preferred stock. We currently intend to retain earnings, if any, to fund the development and growth of our business and do not anticipate paying cash dividends in the foreseeable future. Our payment of any future dividends will be at the discretion of our board of directors after taking into account various factors, including our financial condition, operating results, cash needs and growth plans.

**Transfer Agent and Registrar**

American Stock Transfer & Trust Company is currently the transfer agent and registrar for our common stock. Its address is 6201 15th Avenue, Brooklyn, NY 11219. Its phone number is (800) 937-5449.

**Issuer Purchases of Equity Securities.**

None

**Item 6. Selected Financial Data.**

We are a smaller reporting company as defined by Rule 12b-2 of the Securities Exchange Act of 1934 and are not required to provide the information under this item.

**Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.****Cautionary Notice Regarding Forward-Looking Statements**

This Annual Report on Form 10-K (this “Report”) contains “forward-looking statements” within the meaning of the Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act of 1934, as amended. Forward-looking statements discuss matters that are not historical facts. Because they discuss future events or conditions, forward-looking statements may include words such as “anticipate,” “believe,” “estimate,” “intend,” “could,” “should,” “would,” “may,” “seek,” “plan,” “might,” “will,” “expect,” “predict,” “project,” “forecast,” “potential,” “continue” negatives thereof or similar expressions. These forward-looking statements are found at various places throughout this Report and include information concerning possible or assumed future results of our operations; business strategies; future cash flows; financing plans; plans and objectives of management; any other statements regarding future operations, future cash needs, business plans and future financial results, and any other statements that are not historical facts.

From time to time, forward-looking statements also are included in our other periodic reports on Forms 10-Q and 8-K, in our press releases, in our presentations, on our website and in other materials released to the public. Any or all of the forward-looking statements included in this Report and in any other reports or public statements made by us are not guarantees of future performance and may turn out to be inaccurate. These forward-looking statements represent our intentions, plans, expectations, assumptions and beliefs about future events and are subject to risks, uncertainties and other factors. Many of those factors are outside of our control and could cause actual results to differ materially from the results expressed or implied by those forward-looking statements. In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than we have described. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this Report. All subsequent written and oral forward-looking statements concerning other matters addressed in this Report and attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this Report.

For a discussion of factors that we believe could cause our actual results to differ materially from expected and historical results see “Item 1A - Risk Factors”.

## **Background**

We have completed development of the Coates spherical rotary valve engine (“CSRV<sup>®</sup>”) system technology. This technology has been successfully applied to natural gas fueled industrial electric power CSRV<sup>®</sup> generator engines (“Gen Sets”), automobile engines, residential generators and high performance racing car engines. We have also designed and retrofitted the CSRV<sup>®</sup> system technology into a diesel engine which is suitable for and can be applied to heavy trucks.

In February 2015, we granted a US\$100 million non-exclusive distribution sublicense to a China-based sales and distribution company that covers distribution in the territory of the Western Hemisphere. We also undertook to procure parts and components to commence limited production of our Gen Sets. We are in the final stage of completing production of initial Gen Sets. We intend to perform quality control on these Gen Sets, after which we will begin ramping up production for sales and distribution to end users.

Independent testing on internal combustion engines incorporating the CSRV<sup>®</sup> system technology indicated the following advantages would be derived from this technology:

- Better fuel efficiency
- Reduced harmful emissions

Based on more than ten years of operating a Mercedes 300 with an SE 280 engine retrofitted with the CSRV<sup>®</sup> system technology, the following advantages were demonstrated:

- Longer intervals between engine servicing, and
- Longer engine life than conventional internal combustion engines.

We continue to be engaged in new research and development activities from time-to-time in connection with applying this technology to other commercially feasible internal combustion engine applications and intend to manufacture engines and/or license the CSRV<sup>®</sup> system technology to third party Original Equipment Manufacturers (“OEM’s”) for multiple other applications and uses.

George J. Coates has developed a hydrogen reactor, which rearranges H<sub>2</sub>O water molecules into HOH molecules also known as Hydroxy-Gas. The Hydroxy-Gas produced by the hydrogen reactor is then harvested for use as a type of fuel. Mr. Coates has agreed to continue further development of this technology to enable the harvested Hydroxy-Gas to be utilized as the fuel source to power our patented CSR<sup>®</sup> engines. This technology has been successfully applied to a small CSR<sup>®</sup> engine which is solely powered by Hydroxy-Gas produced by the reactor from water. In addition, the Company and WTF Asia International Ltd., a Hong Kong-based entity have agreed to work together to develop this technology to enable it to be applied to large industrial gen set engines. The Company has fulfilled its obligations under this joint project by designing and integrating the switchgears, controls, load bank and emission equipment into the hydrogen reactor/gen set ("Coates Assembled Components"). On the basis of a verbal agreement, WTF Asia International Ltd. ("WTF") is currently building additional components based on technology already developed that will enable the hydrogen reactor to adequately power larger commercial and industrial engines. Upon completion of the WTF deliverable, the parties intend to enter into a formal agreement and the WTF technology will be integrated with the Coates Assembled Components resulting in a CSR<sup>®</sup> hydrogen powered gen set.

If successful, the hydrogen reactor technology will only require a ready supply of water and would be suitable for stationary engines and generators. Conventional internal combustion engines employing poppet valve assemblies require lubrication and would experience excessive heat and friction if powered with Hydroxy-Gas. This, in turn, would cause the engines to burn out in a rather short period of time. The materials and components of the CSR<sup>®</sup> engines do not require such lubrication and their design enables them to operate relatively trouble-free on Hydroxy-Gas as the engine fuel. There can be no assurance that this technology can be developed successfully, or that if developed, it will be feasible to penetrate the internal combustion engine market with this technology. A number of new related patent applications are in process to protect this intellectual property. Although at this time no arrangements have been made between the Company and George J. Coates, owner of the technology, regarding licensing of the hydrogen reactor, Mr. Coates has provided his commitment to license this technology to the Company once the related patent protection is in place. Accordingly, the Company does not currently have any rights to manufacture, use, sell and distribute the hydrogen reactor technology, should it become commercially feasible to manufacture and distribute products powered by the Hydroxy-Gas fuel. The Company has been and continues to be responsible for all costs incurred related to the development of this technology.

## **Plan of Operation**

### *Manufacturing, Sales and Distribution*

We have completed development of the CSR<sup>®</sup> system technology-based generator engine. We are engaged in retrofitting two Cummins Industrial Engines with our CSR<sup>®</sup> engine technology. These units will be the used to attract new licensing transactions and other manufacturing activities. We will need to raise sufficient new working capital to ramp up our own manufacturing and distribution operations.

In connection with our efforts to secure a large-scale licensing agreement with a major China-based manufacturing company, we are also retrofitting two small diesel engines with our CSR<sup>®</sup> engine technology. Upon completion, the ultra-low emissions and efficiency benefits of retrofitting these diesel engines, will be demonstrated. Currently these types of diesel engines are widely used throughout China and, without the CSR<sup>®</sup> engine technology, produce substantial harmful emissions. Upon acceptance by the China-based manufacturing company, it is expected that the parties will enter into a licensing agreement.

We intend to take advantage of the fact that essentially all the parts and components of the CSR<sup>®</sup> generator engine may be readily sourced and acquired from U.S. based suppliers and subcontractors, and, accordingly, expect to manufacture Gen Sets by developing assembly lines within owned manufacturing facilities. The initial limited production will enable us to prove our concept for the CSR<sup>®</sup> system technology and we expect this will dovetail with the existing substantial demand in the marketplace. We plan to address this demand by establishing large scale manufacturing operations in the United States. Transitioning to large scale manufacturing is expected to require a substantial increase in our work force, securing additional manufacturing capacity and substantial capital expenditures.

Our ability to establish such manufacturing operations, recruit plant workers, finance initial manufacturing inventories and fund capital expenditures is highly dependent on our ability to successfully raise substantial new working capital in an amount and at a pace which matches our business plans. Potential sources of such new working capital include (i) positive working capital generated from sales of our CSR<sup>®</sup> products, (ii) sales of our equity and/or debt securities under our equity purchase agreement with Southridge, (iii) issuance of promissory notes to related parties and issuance of convertible notes, (iv) pursuing and entering into additional sublicensing agreements with OEM's and/or distributors, and (v) positive working capital generated from sales of our CSR<sup>®</sup> products to other customers once we raise sufficient new working capital and commence production. Although we have been successful in raising sufficient working capital to continue our ongoing operations, we have encountered very challenging credit and equity investment markets, and have not been able to raise sufficient new working capital to enable us to commence production of our Gen Sets. There can be no assurance that we will be successful in raising adequate new working capital or even any new working capital to carry out our business plans. The current economic environment, which is characterized by tight credit markets, investor uncertainty about how to safely invest funds and low investor confidence, has introduced additional risk and difficulty to our challenge to secure such additional working capital.

## *Sublicensing*

We plan to sublicense the CSR<sup>®</sup>V system technology to multiple OEM's in order to take advantage of third party manufacturers' existing production capacity and resources by signing OEM agreements.

In February 2015, we granted a non-exclusive distribution sublicense to Renown Power Development, Ltd., a China-based sales and distribution company ("Renown") covering the territory defined as the Western Hemisphere. Under this sublicense, Renown will be permitted to sell, lease and distribute CSR<sup>®</sup>V products. This sublicense provides for payment of licensing fees amounting to US\$100 million. We received an initial non-refundable deposit of US\$500,000 to date. In addition, after Renown receives aggregate cash flow of US\$10,000,000, it is required to pay us 25% of all funds it receives from any and all sources until the entire US\$100 million licensing fee is paid in full. In the event that Renown completes one or more capital raises aggregating US\$300 million or more, the remaining unpaid balance of the US\$100 million licensing fee shall become immediately due and payable.

As collateral for payment of the sublicensing fee, Coates Power, Ltd. an independent China-based manufacturing company that will produce CSR<sup>®</sup>V products in China ("Coates Power") and Renown are to place shares of their capital stock representing a 25% ownership interest into an escrow account for the benefit of Coates International, Ltd. These shares of stock will be released from escrow and revert back to Coates Power and Renown only after the US\$100 million sublicensing fee is paid in full. We do not have an ownership interest in Coates Power or Renown. Coates Power and Renown are controlled and managed by Mr. James Pang, our liaison agent in China.

Coates Power has agreed to initially source two completed Gen Sets from us. We have received payment with order for these two Gen Sets, of approximately US\$131,000. These Gen Sets are expected to be shipped in the near future.

### **Significant Estimates**

The preparation of our financial statements in conformity with generally accepted accounting principles in the United States ("GAAP") requires our management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. These significant estimates include determining the fair value of convertible promissory notes containing embedded derivatives as a result of variable conversion rate provisions, determining a value for Series A Preferred Stock and Series B Convertible Preferred Stock issued in connection with anti-dilution provisions in place, assigning useful lives to the our property, plant and equipment, determining an appropriate amount to reserve for obsolete and slow moving inventory, providing a valuation allowance for deferred tax assets, assigning expected lives to and estimating the rate of forfeitures of stock options granted and selecting a volatility factor for the Company's stock options in order to estimate the fair value of the Company's stock options on the date of grant. Actual results could differ from those estimates.

### **Results of Operations for the Years Ended December 31, 2015 and 2014**

Our principal business activities and efforts during 2015 and 2014 were devoted to (i) negotiating a US \$100 Million non-exclusive distribution license with Renown Power Development, Ltd., a China-based company which was consummated in February 2015, (ii) retrofitting two Cummins Industrial Engines with our CSR<sup>®</sup>V engine technology, (iii) undertaking efforts to raise additional working capital in order to fund ongoing operations and (iv) research and development of the Hydrogen Reactor Technology.

Although we incurred substantial net losses for the years ended December 31, 2015 and 2014 of (\$10,204,580) and (\$12,789,868), respectively, it is important to consider that a substantial portion of these losses resulted from non-cash expenses required to be recorded for financial reporting purposes in accordance with GAAP. These net losses should be considered in view of the fact that actual cash used in operating activities amounting to (\$949,230) and (\$1,571,454) in 2015 and 2014, respectively, was significantly less than these reported net losses. The differences between the reported net losses incurred in 2015 and 2014 are described in detail in the section "Liquidity and Capital Resources".

## **Revenue**

There were no sales in 2015 and 2014.

Sublicensing fee revenue for the years ended December 31, 2015 and 2014 amounted to \$94,200 and \$19,200, respectively. Sublicensing fees are being recognized by amortizing the license deposit of \$300,000 on the Canadian License over the approximate remaining life of the last CSRV<sup>®</sup> technology patent in force. The sublicensing fee for 2015 included the recognition of \$75,000 deposit from an abandoned sublicensing agreement that was recognized as revenue.

## **Expenses**

### *Marketing Expenses*

Marketing decreased to \$6,864 in 2015 from \$48,095 in 2014 primarily due to fees paid to agents in 2014 assisting us with negotiating non-exclusive distribution licenses for CSRV<sup>®</sup> technology products in China and Saudi Arabia. A \$100 million distribution license in China was granted in February 2015 and negotiations in Saudi Arabia are ongoing.

### *Research and Development Expenses*

Research and development activities in 2015 and 2014 were primarily related to the Hydrogen Reactor Project and continuing development of production parts and components for CSRV<sup>®</sup> Industrial Gen Sets. Research and development expenses decreased by \$70,622 or 14% to \$417,145 in 2015 from \$487,767 in 2014. This net decrease is primarily due to (i) a \$54,800 decrease in the amount of compensation and benefits allocated to research and development activities in 2015 and (ii) a decrease in parts and materials utilized in research and development of \$15,822 in 2015.

### *Compensation and Benefits*

Compensation and benefits decreased by \$2,548,515 to \$7,852,456 in 2015 from \$10,400,971 in 2014. This decrease was due to a decrease in stock-based compensation of \$2,599,755 which arises from issuances of Series B Convertible Preferred Stock to George J. Coates, Gregory G. Coates and Barry C. Kaye for anti-dilution and an increase in salaries, wages and benefits of \$51,241, primarily due to a decrease of \$54,800 in the amount of salaries, wages and benefits allocated to and reported as research and development expenses.

### *General and Administrative Expenses*

General and administrative expenses decreased by (\$42,555) to \$532,680 in 2015 from \$575,235 in 2014. This net decrease in 2015 was primarily related to decreases in legal and professional fees of (\$15,232), financing costs of (\$39,632), property taxes of (\$17,595), utilities of (\$8,869), travel and entertainment of (\$5,239), repairs and maintenance of (\$4,338), regulatory compliance costs of (\$2,433), parts expense of (\$2,672), printing costs of (\$2,073) and a net decrease in all other expenses of (\$5,484), partially offset by increases in investor relations costs of \$20,018, building expenses of \$12,629, non-capital equipment purchases of \$10,586, patent maintenance of \$7,969, office expenses of \$5,647, miscellaneous expenses of \$2,119 and warehouse expenses of \$2,044.

In order to preserve our working capital, George J. Coates, Barry C. Kaye and Bernadette Coates have voluntarily agreed to defer payment of a portion of their compensation for certain periods since the first quarter of 2013, which as of April 8, 2016, amounted to \$795,192, \$135,050 and \$208,702, respectively. This deferred compensation is intended to be paid when we are successful in our efforts to raise sufficient new working capital.



### *Depreciation and Amortization*

Depreciation and amortization expense decreased to \$52,552 in 2015 from \$64,920 in 2014.

### **Loss from Operations**

A loss from operations of (\$8,767,497) was incurred in 2015 compared with a loss from operations of (\$11,557,788) in 2014.

### **Other Expense**

#### *Increase in Estimated Fair Value of Embedded Liabilities*

The estimated fair value of embedded liabilities, which relates to outstanding convertible promissory notes, is remeasured at each balance sheet date. For the years ended December 31, 2015 and 2014, an expense was recorded to reflect the increase in the fair value of embedded liabilities of \$157,232 and \$109,105, respectively.

#### *Loss on conversion of convertible notes*

For the years ended December 31, 2015 and 2014, the Company realized a loss on conversion of convertible notes of \$273,160 and \$94,632, respectively.

#### *Interest Expense*

Interest expense decreased to \$1,005,930 in 2015 from \$1,028,343 in 2014. Interest expense in 2015 consisted of non-cash interest related to convertible promissory notes of \$652,773, mortgage loan interest of \$100,162, interest on promissory notes to related parties of \$217,638, interest expense related to the sale/leaseback of equipment of \$32,398 and net other interest of \$2,959. Interest expense in 2014 consisted of non-cash interest related to convertible promissory notes of \$744,203, mortgage loan interest of \$120,524, interest on promissory notes to related parties of \$112,099, interest expense related to the sale/leaseback of equipment of \$51,190 and net other interest of \$327.

### **Deferred Taxes**

In 2015 and 2014, the change in deferred taxes was fully offset by a valuation allowance, resulting in a \$-0- net income tax provision.

### **Net Loss**

For the year ended December 31, 2015, we incurred a net loss of (\$10,203,819) or (\$0.01) per share, as compared with net loss of (\$12,789,868) or (\$0.03) per share for 2014. Included in the net losses for the years ended December 31, 2015 and 2014 was \$8,886,738 and \$11,150,317, respectively, of non-cash expenses, net of non-cash revenues.

### **Liquidity and Capital Resources**

Our cash position at December 31, 2015 was \$29,207, a decrease of \$234,319 from the cash position of \$263,526 at December 31, 2014. We had a working capital deficit of (\$5,475,958) at December 31, 2015 which represents a decrease in the deficit of (\$1,820,164) compared to the (\$7,296,122) of negative working capital at December 31, 2014. Our current liabilities of \$5,732,300 at December 31, 2015, decreased by \$1,919,496 from \$7,651,796 at December 31, 2014. This net decrease primarily resulted from (i) reclassification of \$1,388,284 of the current portion of the mortgage loan payable to non-current portion of the mortgage loan payable because the mortgage loan was extended for three years during 2015, (ii) the reclassification of the \$456,775 non-current portion of the deposit from Renown, upon becoming non-refundable, to non-current liabilities, (iii) a net reduction in deferred compensation payable of \$157,760, (iv) net repayment of \$109,623 of promissory notes to related parties, (v) a \$92,795 decrease in the carrying amount of convertible notes, net of unamortized discount, and (vi) payment of \$42,753 of the current portion of the finance lease obligation, partially offset by (i) a \$157,232 net increase in derivative liability related to convertible promissory notes, (ii) a \$131,471 increase in a deposit for an order and (iii) a \$39,171 increase in accounts payable and accrued liabilities.

Operating activities utilized cash of (\$949,230) for the year ended December 31, 2015, a decrease of \$622,224 from the cash utilized for operating activities of (\$1,571,454) for the year ended December 31, 2014. Cash utilized by operating activities in the year ended December 31, 2015 resulted primarily from (i) a cash basis net loss of (\$1,317,080) (after adding back non-cash stock-based compensation expense of \$7,574,503, non-cash interest and amortization of discount on convertible notes and finance lease obligation of \$878,251, a non-cash loss on conversion of convertible notes of \$273,160, a non-cash increase in embedded derivative liabilities related to convertible notes of \$157,232, depreciation and amortization of \$52,552 and the \$45,240 non-cash portion of inventory used in research and development, partially offset by recognition of non-cash licensing revenues of (\$94,200); and (ii) a decrease in inventory of (\$170,744), an increase in deferred offering costs and other assets of \$35,757, an increase of \$54,126 in accounts payable and accrued liabilities, an increase in deferred compensation payable of \$317,240 and an increase in deposits with order of \$131,471.

Cash used for investing activities consisted of \$38,249 for acquisitions of property, plant and equipment in 2015.

Cash generated from financing activities amounted to \$753,160 in 2015. This was comprised of issuances of convertible promissory notes aggregating \$630,500, proceeds of \$407,261 from sales of common stock under an equity purchase agreement with Southridge Partners II LP, partially offset by net repayments of promissory notes held by related parties of (\$109,623), payments of a finance lease obligation amounting to (\$62,102), principal repayments of (\$60,126) on the mortgage loan payable and repayment of convertible promissory notes of (\$52,750).

### **Going Concern**

We have incurred net recurring losses since inception, amounting to (\$56,970,998), as of December 31, 2015 and had a stockholders' deficiency of (\$5,299,053). We will need to obtain additional working capital in order to continue to cover our ongoing cash expenses.

These factors raise substantial doubt about our ability to continue as a going concern. In addition, the current economic environment, which is characterized by tight credit markets, investor uncertainty about how to safely invest funds and low investor confidence, has introduced additional risk and difficulty to our challenge to secure needed additional working capital. Our Independent Registered Public Accountants have stated in their Auditor's Report dated April 14, 2016 with respect to our financial statements as of and for the year ended December 31, 2015 that these circumstances raise substantial doubt about our ability to continue as a going concern.

During 2015, we restricted variable costs to only those expenses that are necessary to perform activities related to efforts to negotiate sublicenses for distribution of our CSRV<sup>®</sup> products, raising working capital to enable us to commence production of our CSRV<sup>®</sup> system technology products, research and development and general administrative costs in support of such activities.

During the years ended December 31, 2015 and 2014, we raised \$1,107,761 and \$2,180,519, respectively, of new working capital from issuances of convertible promissory notes, sales of registered shares common stock under equity purchase agreements, issuances of promissory notes to related parties in 2015, a deposit received on a sublicense in 2014, sales of our common stock and common stock warrants in 2014 and from exercise of common stock purchase warrants in 2014.

Our financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

Additional Release Payments from Almont are currently due us amounting to \$5,847,000 under the Escrow Agreement. At this time, Almont is unable to pay the balance due us until it raises sufficient new working capital. As a result, we have needed to rely on other sources for raising new working capital for our operations.

Sources of working capital and new funding being pursued by us include (i) sales of common stock and warrants under an equity purchase agreement, (ii) issuances of promissory notes and convertible promissory notes, (iii) new equity investment and/or up front licensing fees from prospective new sublicensees and, (iv) manufacturing and sales of CSRV® Units. There can be no assurance that we will be successful in securing any of these sources of additional funding. In this event, we may be required to substantially or completely curtail our operations, which could have a material adverse affect on our operations and financial condition.

At December 31, 2015, current liabilities were primarily comprised of promissory notes due to related parties aggregating \$1,455,882, \$1,367,727 of legal and professional fees, deferred compensation of \$922,144, an embedded derivative liability related to convertible promissory notes of \$632,927, \$408,110 of convertible promissory notes, net of unamortized discount, accrued interest payable of \$376,108, accrued general and administrative expenses of \$163,874, deposits with orders of \$150,595, accrued research and development expenses of \$114,859, the current portion of license deposits of \$60,725, the current portion of a mortgage loan amounting to \$60,000 and the current portion of a finance lease obligation of \$19,349.

### Contractual Obligations and Commitments

The following table summarizes our contractual obligations and commitments at December 31, 2015:

	Total	Due Within		
		2016	2017	2018
Promissory notes to related parties	\$ 1,455,982	\$ 1,455,982	\$ -	\$ -
Mortgage loan payable	1,388,158	60,000	60,000	1,268,158
Deferred compensation	922,144	922,144	-	-
Convertible promissory notes	558,000	294,000	264,000	-
Finance lease obligation	22,255	22,255	-	-
Total	<u>\$ 4,346,539</u>	<u>\$ 2,754,381</u>	<u>\$ 324,000</u>	<u>\$ 1,268,158</u>

### Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

### Critical Accounting Policies

The Company's significant accounting policies are presented in the Company's notes to financial statements for the period ended December 31, 2015 which are contained in this filing, the Company's 2015 Annual Report on Form 10-K. The significant accounting policies that are most critical and aid in fully understanding and evaluating the reported financial results include the following:

The Company prepares its financial statements in conformity with generally accepted accounting principles in the United States of America. These principals require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management believes that these estimates are reasonable and have been discussed with the Board of Directors; however, actual results could differ from those estimates.

Long-lived assets such as property, equipment and identifiable intangibles are reviewed for impairment whenever facts and circumstances indicate that the carrying value may not be recoverable. When required, impairment losses on assets to be held and used are recognized based on the fair value of the asset. The fair value is determined based on estimates of future cash flows, market value of similar assets, if available, or independent appraisals, if required. If the carrying amount of the long-lived asset is not recoverable from its undiscounted cash flows, an impairment loss is recognized for the difference between the carrying amount and fair value of the asset. When fair values are not available, the Company estimates fair value using the expected future cash flows discounted at a rate commensurate with the risk associated with the recovery of the assets. We did not recognize any impairment losses for any periods presented.

Other significant estimates include determining the fair value of convertible promissory notes containing embedded derivatives and variable conversion rates, determining a value for Series A Preferred Stock and Series B Convertible Stock issued and certain limited anti-dilution rights granted to George J. Coates, assigning useful lives to the Company's property, plant and equipment, determining an appropriate amount to reserve for obsolete and slow moving inventory, estimating a valuation allowance for deferred tax assets, assigning expected lives to, and estimating the rate of forfeitures of, stock options granted and selecting a trading price volatility factor for the Company's common stock in order to estimate the fair value of the Company's stock options on the date of grant or other appropriate measurement date. Actual results could differ from those estimates.

### **New Accounting Pronouncements**

In November 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2015-17, "Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes". This update was designed to simplify the presentation of deferred taxes by eliminating the requirement to separately classify the current and non-current portion of deferred tax assets and liabilities. Accordingly, this update will require that all deferred tax assets and liabilities be presented as non-current. This update will become effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Earlier application is permitted as of the beginning of an interim or annual reporting period. The Company is currently evaluating the impact of this update and the transition alternatives, however, at this time it does not expect it will have a material effect on its financial statements.

In July 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2015-11, "Inventory – Simplifying the Measurement of Inventory (Topic 330)". This update requires that inventory value be measured at the lower of cost or net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. Currently, generally accepted accounting principles require that inventory be valued at the lower of cost or market price to replace the inventory. This update is to become effective for annual and interim financial statements for fiscal years ending after December 15, 2016. Earlier application is permitted. This update is required to be applied prospectively. The Company is currently evaluating the impact of this update; however, at this time it does not expect it will have a material effect on its financial statements.

In August 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-15, "Presentation of Financial Statements - Going Concern (Subtopic 205-40)", which was issued in order to provide guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related financial statement disclosures. It requires that management evaluate whether there are conditions or events, when considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date of both the annual and interim financial statements ("Going Concern Doubt"). The evaluation should be based on relevant conditions and events that are known and reasonably knowable at the date of the financial statements. When such evaluation determines that Going Concern Doubt does exist, then management is required to consider whether or not it is probable that its plans to mitigate the Going Concern Doubt can be effective and timely to address the Going Concern Doubt. This update further provides disclosure requirements in the notes to financial statements both when such doubt is probable of being mitigated and when such doubt is not probable of being mitigated by management's plans. This update is to become effective for annual and interim financial statements for fiscal years ending after December 15, 2016. As permitted thereunder, we have elected to implement this update early and it has been applied in the financial statements for the years ended December 31, 2015 and 2014 included in this Form 10-K. Early adoption did not have a material effect on our financial position or results of operations.

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers (Topic 606)", which amended the existing accounting standards for revenue recognition. This update is based on the principle that revenue should be recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The Company is required to adopt this updated standard in the first quarter of fiscal 2018. Early adoption is not permitted. The amendments may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. The Company is currently evaluating the impact of this update and the transition alternatives, however, at this time it does not expect it will have a material effect on its financial statements.

**Item 7A. Quantitative and Qualitative Disclosures about Market Risk.**

We are not required to provide the information required by this Item because we are a smaller reporting company.

**Item 8. Financial Statements and Supplementary Data.**

Reference is made to the Financial Statements as of and for the Years ended December 31, 2015 and 2014 beginning on page F-1.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

None.

**Item 9A. Controls and Procedures.****Evaluation of Disclosure Controls and Procedures**

Pursuant to Rule 13a-15(b) under the 1934 Act, the Company carried out an evaluation, with the participation of our management, including the Company's Chief Executive Officer ("CEO") (the Company's principal executive officer) and Chief Financial Officer ("CFO") (the Company's principal financial and accounting officer), of the effectiveness of the Company's disclosure controls and procedures (as defined under Rule 13a-15(e) under the Exchange Act) as of the end of the period covered by this report. Based upon that evaluation, the Company's CEO and CFO concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports that the Company files or submits under the Exchange Act, is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including the Company's CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

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

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Our internal control system was designed to, in general, provide reasonable assurance to the Company's management and board regarding the preparation and fair presentation of published financial statements, but because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2015. The framework used by management in making that assessment was the criteria set forth in the document entitled "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that assessment, our management has determined that as of December 31, 2015, the Company's internal control over financial reporting was effective for the purposes for which it is intended.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm as we are a smaller reporting company and not required to provide the report.

**Changes in Internal Controls over Financial Reporting**

There were no changes in our internal controls over financial reporting that occurred during the fourth quarter of the fiscal year ended December 31, 2015 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B. Other Information.**

None.

### PART III

#### Item 10. Directors, Executive Officers and Corporate Governance.

The following table lists the current members of our board of directors and our executive officers as of April 8, 2016. Our directors hold office until their successors have been duly elected and qualified. The address for our directors is c/o Coates International, Ltd., Highway 34 & Ridgewood Road, Wall Township, New Jersey 07719. There are no family relationships among members of our board or our executive officers, with the exception of Gregory G. Coates, who is the son of George J. Coates. The board of directors did not meet during the year ended December 31, 2015.

<u>Name</u>	<u>Age</u>	<u>Position</u>
George J. Coates	76	Director, Chairman of the Board, Chief Executive Officer and President
Gregory G. Coates	45	Director, Secretary and President, Technology Division
Barry C. Kaye	62	Director, Treasurer and Chief Financial Officer
Jack Perkowski	67	Director *, **
Dr. Frank Adipietro	58	Director *, ***
Richard Whitworth	67	Director *, **, ***

\* Serves as an independent director.

\*\* Serves as a member of our audit committee.

\*\*\* Serves as a member of our compensation committee.

George J. Coates is our founder and, with the exception of a short period of time of less than one year, has served from the inception of the Company as a director, Chairman of the Board of Directors, President and Chief Executive Officer.

George J. Coates has served two apprenticeships in Europe while attending the College of Technology in London, and as an associate member of the Society of Automotive Engineers ("SAE") where he received The City and Guilds of London for electrical and mechanical engineering. He is a former management director of SCR Motor Engineers of Europe and holds the certificate of Ministry of Transport in the United Kingdom. He worked as an engineer for Rolls Royce and Mercedes Benz, BLMC, Austin, and D. Napier. He holds approximately 300 patents worldwide on innovations and technologies, including the CSRV<sup>®</sup> system technology and a turbine engine, among others. He invented coolant disc brakes and a hydraulic suspension. Mr. Coates is a licensed inspector of the New Jersey Motor Vehicle Commission.

He has delivered lectures and presentations at:

- RWTH Aachen University, Aachen, Germany
- University of Birmingham, Birmingham, England
- Rutgers University, Newark, New Jersey, USA.

He is a member of the American Society of Mechanical Engineers and SAE. He received awards in 1995 for achievement in designs in automotive engineering from the SAE. He also received awards in 2001 for outstanding achievements in Mechanical Engineering from the American Society of Mechanical Engineers. Mr. Coates has extensive experience in international corporate business and has developed many longtime associates and contacts in the business and scientific communities around the world.

Gregory G. Coates became a director of the Company in October 2006, and had served as the Chairman of our Board of Directors until March 2007. In October 2006, he became our President – Technology Division. For more than twenty years, Gregory G. Coates has worked with us as a design engineer, working in research and development, designing and building the CSRV<sup>®</sup> system technology and adapting this technology to various existing applications. He created certain of our licensed inventions, and patented certain of them. Gregory G. Coates is an Associate Member of the Society of Automotive Engineers, Inc., and a Member of the American Society of Mechanical Engineers. He graduated from the College of Technology in Ireland. He invented and patented the Multi Sequential Fuel Management System<sup>®</sup>, a vital component of our CSRV<sup>®</sup> engines and also holds patents on other innovative technologies.

Barry C. Kaye became a director of the Company in October 2006 and has been serving as our Treasurer and Chief Financial Officer since October 2006. Mr. Kaye is a Certified Public Accountant in both New York and New Jersey. Mr. Kaye served as Vice President, Finance from 2009 to 2010 for Results Media, LLC, a company that provided direct mail marketing services. From 2006 to 2009, Mr. Kaye served as Vice President, Finance and Operations for Corporate Subscription Management Services, LLC, a company that processes orders as agent for various publishers. Since 1999, he has been serving as an Executive Business Consultant with BCK Business Consulting which provides various business consulting services to the business community. From 2004 to 2005, Mr. Kaye served as Corporate Controller of Development Corporation for Israel, a registered broker-dealer that distributes bonds of the government of Israel. He was the Vice President, Finance & Operations for Alliance Corner Distributors, Inc., a company engaged in sales and distribution of video games and other forms of digital entertainment media from 2003 to 2004. From 1987 to 1999, he served as Group Vice President, Finance at Sharp Electronics Corporation, a \$3.5 billion company engaged in sales and distribution of consumer electronics, office equipment products and microelectronic components, where he was responsible for all finance and “back office” operations. From 1976 to 1987, Mr. Kaye worked for Arthur Andersen & Co. where he achieved the position of Senior Audit Manager. He is a member of the American Institute of Certified Public Accountants as well as a member of the New York and New Jersey State Societies of Certified Public Accountants. Mr. Kaye received his Bachelor of Science in Accounting degree, graduating with Cum Laude distinction from Brooklyn College of the City University of New York.

Jack Perkowski became a director of the Company in February 2015. He was also elected to serve as Chairman of our Audit Committee of the Board of Directors. Mr. Perkowski is widely recognized as an expert on doing business in China. Jack graduated Cum Laude from Yale University and with High Distinction from Harvard Business School where he was named a Baker Scholar. He spent eighteen years on Wall Street, rising to head of investment banking at PaineWebber. Jack demonstrated his visionary leadership by devoting three years investigating opportunities in Asia and China, well before others would learn to appreciate the significant role that China would come to play in the global economy. This led to the founding of ASIMCO Technologies, a major industrial enterprise, which he built and managed for fifteen years.

Under Jack’s leadership, ASIMCO gained a reputation for developing local management and integrating a broad based China operation into the global economy. ASIMCO grew into one of the largest automobile components manufacturers in China with 12,000 employees at 17 plants in 8 provinces. ASIMCO was twice named one of the “Ten Best Employers in China” in surveys conducted by Hewitt Associates and leading news organizations in Asia. In 2008, Jack was designated by China Auto News, as one of “30 Outstanding Entrepreneurs in China’s Auto Components Industry over the 30 Years of Economic Reform,” the only foreigner to receive this distinction.

He authored “Managing the Dragon: How I’m Building a Billion Dollar Business in China”, and provides timely insights into ongoing developments in the country on [www.managingthedragon.com](http://www.managingthedragon.com). His articles on China, its economy and developing a business in the country have been published in the Wall Street Journal, the Far Eastern Economic Review, the Huffington Post, Am Cham’s China Brief and Business Forum China. Jack is a frequent speaker to university and business school groups, corporate and industry conferences and leading professional organizations such as the Council on Foreign Relations, the Asia Society and the YPO, and has been interviewed on CNN, CNBC, Fox, BBC, NPR, and CCTV. Jack’s unique journey to China has been featured in many articles on the subject.

Jack serves on the Board of Directors of Credit First Financial Leasing Co., Inc., China’s first independent auto leasing company, and OC3 Entertainment, the leading provider of facial animation software in the world. Previously, Jack served on the Board of Directors and as the head of the Special Committee of NASDAQ listed Fushi Copperweld, Inc., the world’s leading bimetallic company, which went private in 2013. Jack is also a member of the China Advisory Council of Magna International, Inc., one of the largest suppliers to the auto industry, and a member of JP Morgan’s “China Expert Series.” Jack has also been named a Distinguished Speaker at the University of Virginia’s Darden School of Business.

In April 2009, Jack founded JFP Holdings, a merchant banking firm focused on China, where he now serves as Managing Partner. JFP Holdings is headquartered in Beijing, has representatives in the United States, Japan and the United Kingdom, and was established to help Western companies bring their products, technology and know-how to China and assist Chinese companies with global expansion.

The JFP Holdings team includes management and investment professionals with deep experience in China and significant investment banking experience. JFP Holdings is uniquely positioned to assist Western companies develop their strategies for the China market and to help them implement and fund their China strategies. With its knowledge of both China and the world's developed markets, JFP Holdings provides Chinese companies with value added advice on their overseas expansion plans.

Dr. Frank J. Adipietro became a director of the Company in October 2006. Dr. Adipietro earned an M.D. degree from Downstate Medical School, Brooklyn, New York. He has also earned an undergraduate degree from New York University, graduating with Phi Beta Kappa and Magna Cum Laude distinction. He has been practicing in the area of anesthesia and interventional pain management for more than twenty years. He serves as President of the Medical Staff at Eastern Long Island Hospital in Greenpoint, New York since 2009 and serves on numerous hospital committees. He was affiliated with Lenox Hill Hospital, New York, NY for more than ten years in the field of anesthesiology.

Richard Whitworth became a director of the Company in October 2006. Mr. Whitworth earned a Bachelor of Science degree from the University of Florida and has completed extensive post-graduate coursework and seminars in Law, Public Administration, Health Policy, Finance, Criminal Justice, Social Work and Education. He has been serving as the president of the Whitworth Group Inc. for more than the past 20 years. The Whitworth Group specializes in governmental and public relations, organizational development and financial services. Prior to that, he was the Director for the DWI Program Office for the Florida Supreme Court from 1979 to 1987. From 1976 to 1978 he was the Director of Prevention for the Florida Association Drug Abuse Treatment and Education Centers, Inc. From 1974 to 1976 he served as Specialist, Health and Mental Health, Aging Program Office for the Department of Health and Rehabilitation Services. Prior to that, he was the Director of Prevention for the Drug Abuse Program under the direction of the Department of Health and Rehabilitation Services.

#### **Family Relationships**

George J. Coates is the father of Gregory G. Coates. Bernadette Coates, the spouse of George J. Coates, is employed as an administrative manager of the Company. No other family relationships exist between the directors and executive officers of the Company.

#### **Board Committees**

Our board of directors established an audit committee and a compensation committee in October 2006. All of the members of each of these standing committees are independent as defined under NASDAQ rules and, in the case of the audit committee, the independence requirements contemplated by Rule 10A-3 under the Securities Exchange Act.

##### *Audit Committee*

Jack Perkowski is the Chairman and Richard Whitworth is a member of the audit committee. The audit committee's responsibilities include: appointing, approving the compensation of, and assessing the independence of our independent auditor; overseeing the work of our independent auditor, including through the receipt and consideration of reports from the independent auditor; reviewing and discussing with management and our independent auditor our annual and quarterly financial statements and related disclosures; monitoring our internal control over financial reporting, disclosure controls and procedures, and code of business conduct and ethics; discussing our risk management policies; establishing policies regarding hiring employees from our independent auditor and procedures for the receipt and retention of accounting related complaints and concerns; meeting independently with our independent auditor and management; and preparing the audit committee report required by SEC rules to be included in our proxy statements, if any.



All audit services and all non-audit services, except de minimis non-audit services, must be approved in advance by the audit committee.

Our board of directors has determined that it does not have a member of its audit committee that qualifies as an "audit committee financial expert" as defined in Item 407(d)(5)(ii) of Regulation S-K, and is "independent" as the term is used in Item 7(d)(3)(iv) of Schedule 14A under the Securities Exchange Act of 1934, as amended. We have not been able to identify a qualified audit committee financial expert to serve in such capacity.

During the years ended December 31, 2015 and 2014, the Audit Committee held four audit committee meetings and one audit committee meeting, respectively. In connection with the audit of our financial statements as of and for each of the two years ended December 31, 2015 by Cowan, Guteski & Co., P.A., our Independent Public Accounting Firm, our audit committee has communicated with Cowan, Guteski & Co., P.A. regarding the matters required to be discussed by the Statement on Auditing Standards No. 61 as adopted by the Public Company Accounting Oversight Board in Rule 3200T. In addition, the audit committee has received the written disclosures and the letter from Cowan, Guteski & Co., P.A. required by Independence Standards Board Standard No. 1 as adopted by the Public Company Accounting Oversight Board in Rule 3600T and has discussed with Cowan, Guteski & Co., P.A. their independence.

The audit committee has reviewed and discussed our audited financial statements as of and for each of the two years ended December 31, 2015 with management and based on this review and discussion has recommended to the board of directors that such audited financial statements be included in this annual report on Form 10-K for filing with the Securities and Exchange Commission.

#### *Compensation Committee*

Dr. Frank J. Adipietro and Richard Whitworth serve on the compensation committee. The compensation committee's responsibilities include:

- annually reviewing and approving corporate goals and objectives relevant to compensation of our chief executive officer;
- determining the compensation of our chief executive officer;
- reviewing and approving, or making recommendations to our board of directors with respect to the compensation of our other executive officers;
- overseeing an evaluation of our senior executives;
- overseeing and administering our cash and equity incentive plans; and
- reviewing and making recommendations to our board with respect to director compensation.

The Compensation Committee did not meet during the years ended December 31, 2015 and 2014. There were no changes to any executive's compensation during this period.

#### **Corporate Governance**

We believe that good corporate governance is important to ensure that, as a public company, we will manage for the long-term benefit of our stockholders. In that regard, we have established and adopted charters for the audit committee and compensation committee, as well as a code of business conduct and ethics applicable to all of our directors, officers and employees. Our code of business conduct and ethics can be viewed on our website at [www.coatesengine.com](http://www.coatesengine.com).

#### **Compensation Committee Interlocks and Insider Participation**

George J. Coates, Gregory G. Coates and Barry C. Kaye are executive officers and members of our board of directors. None of our executive officers serves as a member of our compensation committee, audit committee or other committee serving an equivalent function. None of the current members of the compensation committee of our board have ever been employed by us.

## **Liability Limitations and Indemnification**

The following description is intended as a summary only and is qualified in its entirety by reference to our amended and restated certificate of incorporation and amended and restated by-laws incorporated by reference as exhibits into this report. We refer in this section to our amended and restated certificate of incorporation as our certificate of incorporation, and we refer to our amended and restated by-laws as our by-laws.

Our certificate of incorporation and by-laws limit the liability of directors to the maximum extent permitted by Delaware law. Delaware law provides that directors of a corporation will not be personally liable for monetary damages for breach of their fiduciary duties as directors, except liability for:

- any breach of their duty of loyalty to the corporation or its stockholders;
- acts or omissions that are not in good faith or that involve intentional misconduct or a knowing violation of law;
- unlawful payments of dividends or unlawful stock repurchases or redemptions; or
- any transaction from which a director derived an improper personal benefit.

The limitations do not apply to liabilities arising under the federal securities laws and do not affect the availability of equitable remedies, including injunctive relief or rescission.

Our certificate of incorporation and by-laws provide that we will indemnify our directors and officers, and may indemnify other employees and agents, to the maximum extent permitted by law. We believe that indemnification under our by-laws covers at least negligence and gross negligence on the part of indemnified parties. Our by-laws also permit us to secure insurance on behalf of any officer, director, employee or agent for any liability arising out of actions taken in his or her capacity as an officer, director, employee or agent, regardless of whether the by-laws would permit indemnification.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to our directors, officers and controlling persons under our certificate of incorporation or by-laws or the indemnification agreements we have entered into with our directors and officers, we have been advised that in the opinion of the SEC, this indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable.

## **Involvement in Certain Legal Proceedings**

We are currently not involved in any litigation that we believe could have a materially adverse effect on our financial condition or results of operations. There is no action, suit, proceeding, inquiry or investigation before or by any court, public board, government agency, self-regulatory organization or body pending or, to the knowledge of the executive officers of our company or any of our subsidiaries, threatened against or affecting our company, our common stock, any of our subsidiaries or of our company's or our company's subsidiaries' officers or directors in their capacities as such, in which an adverse decision could have a material adverse effect.

To the best of our knowledge, none of our directors or executive officers has, during the past ten years:

- been convicted in a criminal proceeding or been subject to a pending criminal proceeding (excluding traffic violations and other minor offenses);
- had any bankruptcy petition filed by or against the business or property of the person, or of any partnership, corporation or business association of which he was a general partner or executive officer, either at the time of the bankruptcy filing or within two years prior to that time;
- been subject to any order, judgment, or decree, not subsequently reversed, suspended or vacated, of any court of competent jurisdiction or federal or state authority, permanently or temporarily enjoining, barring, suspending or otherwise limiting, his involvement in any type of business, securities, futures, commodities, investment, banking, savings and loan, or insurance activities, or to be associated with persons engaged in any such activity;

- been found by a court of competent jurisdiction in a civil action or by the Securities and Exchange Commission or the Commodity Futures Trading Commission to have violated a federal or state securities or commodities law, and the judgment has not been reversed, suspended, or vacated;
- been the subject of, or a party to, any federal or state judicial or administrative order, judgment, decree, or finding, not subsequently reversed, suspended or vacated (not including any settlement of a civil proceeding among private litigants), relating to an alleged violation of any federal or state securities or commodities law or regulation, any law or regulation respecting financial institutions or insurance companies including, but not limited to, a temporary or permanent injunction, order of disgorgement or restitution, civil money penalty or temporary or permanent cease-and-desist order, or removal or prohibition order, or any law or regulation prohibiting mail or wire fraud or fraud in connection with any business entity; or
- been the subject of, or a party to, any sanction or order, not subsequently reversed, suspended or vacated, of any self-regulatory organization (as defined in Section 3(a)(26) of the Exchange Act), any registered entity (as defined in Section 1(a)(29) of the Commodity Exchange Act), or any equivalent exchange, association, entity or organization that has disciplinary authority over its members or persons associated with a member.

#### Item 11. Executive Compensation.

The following table sets forth the compensation of specified executive officers and directors for the years ended December 31, 2015 and 2014:

**Summary Compensation Table**

Name and Principal Position	Year	Salary	Stock Option Awards	Anti-dilution and Stock Awards	Compensatory Award	All Other Compensation	Total
George J. Coates <i>Chief Executive Officer and President</i>	2015	\$ 250,000 <sup>(1)</sup>	\$ -	\$ 7,439,024 <sup>(2)</sup>	\$ -	\$ 17,685 <sup>(5)</sup>	\$ 7,706,709
	2014	250,000 <sup>(1)</sup>	-	8,007,234 <sup>(3)</sup>	950,000 <sup>(4)</sup>	17,129 <sup>(5)</sup>	9,221,363
Barry C. Kaye <i>Chief Financial Officer and Treasurer</i>	2015	-	-	39,646 <sup>(7)</sup>	-	83,000 <sup>(9)</sup>	122,646
	2014	-	9,837 <sup>(6)</sup>	44,144 <sup>(8)</sup>	-	170,000 <sup>(9)</sup>	223,981
Gregory G. Coates <i>President, Technology Division</i>	2015	155,769 <sup>(10)</sup>	-	506,427 <sup>(12)</sup>	-	22,200 <sup>(5)</sup>	684,396
	2014	161,539 <sup>(10)</sup>	9,837 <sup>(11)</sup>	607,071 <sup>(13)</sup>	-	21,288 <sup>(5)</sup>	799,735

- (1) For each of the two years ended December 31, 2015 and 2014, George J. Coates was paid \$-0- of this salary amount and \$250,000 of his salary was deferred until such time that we have sufficient working capital to pay such deferred compensation.
- (2) During the year ended December 31, 2015, George J. Coates received 2,708,430 shares of Series B Convertible Preferred Stock with an estimated fair value of \$7,439,024 were granted and issued to George J. Coates, pursuant to an anti-dilution agreement.
- (3) During the year ended December 31, 2014, George J. Coates received anti-dilution and stock awards consisting of the following: 90,191 shares of Series A Preferred Stock with an estimated fair value of \$169,452 granted and issued pursuant to an anti-dilution agreement and a stock award. He also received compensation with an estimated value of \$2,793,992 representing the incremental value of 181,664 shares of Series B Convertible Preferred Stock received upon conversion of 181,664 shares of Series A Preferred Stock. In addition, 360,269 shares of Series B Convertible Preferred Stock with an estimated fair value of \$5,025,545 were granted and issued to George J. Coates, pursuant to an anti-dilution agreement.
- (4) During the year ended December 31, 2014, Mr. Coates was granted an award of \$950,000 in the form of a non-interest bearing promissory note to compensate him for the lost benefits of ownership of the Company's headquarters research and development and warehouse facility subsequent to the date he contributed this property to the Company.

- (5) Other compensation for George J. Coates and Gregory G. Coates consisted of health, dental and life insurance for the years ended December 31, 2015 and 2014.
- (6) During the year ended December 31, 2014, we granted 351,500 common stock options with an exercise price of \$0.028 per share to Barry C. Kaye. The estimated fair value of these stock options on the date of grant was \$9,837. These stock options became fully vested in April 2015 and expire in 2029.
- (7) During the year ended December 31, 2015, 14,435 shares of Series B Convertible Preferred Stock with an estimated fair value of \$39,648 were granted and issued to Barry C. Kaye, pursuant to an anti-dilution agreement.
- (8) During the year ended December 31, 2014, 2,976 shares of Series B Convertible Preferred Stock with an estimated fair value of \$44,144 were granted and issued to Barry C. Kaye, pursuant to an anti-dilution agreement.
- (9) During the years ended December 31, 2015 and 2014, Barry C. Kaye was paid compensation of \$83,000 and \$170,000, respectively. For the year ended December 31, 2015, Mr. Kaye earned compensation of \$100,175 which was not paid and is being deferred until the Company has sufficient working capital to remit payment to him. This amount is included in accounts payable and accrued liabilities in the Company's balance sheet at December 31, 2015.
- (10) Includes salary paid to Gregory G. Coates for vacation earned, but not taken.
- (11) During the year ended December 31, 2014 we granted 351,500 common stock options with an exercise price of \$0.028 per share to Gregory G. Coates. The estimated fair value of these stock options on the date of grant was \$9,837. These stock options become fully vested in April 2015 and expire in 2029.
- (12) During the year ended December 31, 2015, 184,382 shares of Series B Convertible Preferred Stock with an estimated fair value of \$506,427 were granted and issued to Gregory G. Coates, pursuant to an anti-dilution agreement.
- (13) During the year ended December 31, 2014, 40,593 shares of Series B Convertible Preferred Stock with an estimated fair value of \$607,071 were granted and issued to Gregory G. Coates, pursuant to an anti-dilution agreement.

#### Outstanding Equity Awards at Fiscal Year End

The following table presents the outstanding equity awards to our executives as of December 31, 2015:

Name	Number of Securities Underlying Unexercised Options that are Exercisable	Number of Securities Underlying Unexercised Options that are Unexercisable	Equity Incentive Plan Awards:		Exercise Price	Option Expiration Date
			Number of Securities Underlying Unexercised Options	Number of Securities Underlying Unexercised Options		
George J. Coates	1,000,000	-	-	-	\$ 0.440	10/23/2021
	50,000	-	-	-	0.430	11/3/2024
	275,000	-	-	-	0.400	11/18/2025
	1,800,000	-	-	-	0.250	7/26/2026
Gregory G. Coates	1,815,000	-	-	-	0.060	6/24/27
	500,000	-	-	-	0.440	10/23/2021
	1,800,000	-	-	-	0.240	8/8/2026
Barry C. Kaye	351,500	-	-	-	0.028	4/30/2029
	125,000	-	-	-	0.440	10/17/2021
	100,000	-	-	-	0.042	12/9/2028
	351,500	-	-	-	0.028	4/30/2029

Vesting of the stock options is subject to acceleration under certain circumstances in the event of an acquisition of the Company.

### Director Compensation

A compensation program was adopted by the board of directors which provides for compensation to our directors in the amount of \$1,000 per day, plus reasonable travel expenses. This compensation plan further provides for the granting of stock options to our non-employee directors from time to time under our 2014 Stock Option and Incentive Plan to purchase our common stock at an exercise price equal to the quoted closing price of our common stock on the day prior to the date of grant.

We did not pay any compensation to our non-employee directors for the years ended December 31, 2015 and 2014.

### Employment contracts, termination of employment and change-in-control arrangements

There are currently no employment contracts with any of our employees and there have been no terminations or change-in-control arrangements.

### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The following table sets forth information with respect to the beneficial ownership of our common stock as of April 8, 2016 for:

- each of our executive officers and directors;
- all of our executive officers and directors as a group; and
- any other beneficial owner of more than 5% of our outstanding common stock.

Beneficial ownership is determined in accordance with the rules of the SEC. These rules generally attribute beneficial ownership of securities to persons who possess sole or shared voting power or investment power with respect to those securities and include ordinary shares issuable upon the exercise of stock options that are immediately exercisable or exercisable within 60 days. Except as otherwise indicated, all persons listed below have sole voting and investment power with respect to the shares beneficially owned by them, subject to applicable community property laws. The information is not necessarily indicative of beneficial ownership for any other purpose.

Percentage ownership calculations are based on 1,272,052,872 shares outstanding as of April 8, 2016. Addresses of named beneficial owners are c/o Coates International, Ltd., 2100 Highway 34 & Ridgewood Road, Wall Township, New Jersey 07719.

Name of Beneficial Owner	Beneficial Ownership			
	Outstanding Shares Beneficially Owned	Right to Acquire Within 60 Days After April 8, 2016	Shares Beneficially Owned	
			Number	Percentage
George J. Coates	260,478,267 <sup>(1)(2)</sup>	4,940,000	265,418,267	19.69%
Gregory G. Coates	14,032,520 <sup>(3)</sup>	2,651,500	16,684,020	1.23%
Dr. Frank Adipietro	3,735,364	827,000	4,562,364	0.34%
Barry C. Kaye	1,300,358 <sup>(4)</sup>	576,500	1,876,578	0.14%
Richard Whitworth	-	25,000	25,000	0.00%
Jack Perkowski	-	-	-	0.00%
All executive officers and directors as a group (6 persons)	<u>279,546,509</u>	<u>9,020,000</u>	<u>288,566,509</u>	<u>23.78%</u>

- (1) Includes 1,956,960 shares owned by Mr. Coates' spouse and 1,165,507 shares owned by The Coates Trust, a trust controlled by George J. Coates as Trustee. Beneficial ownership of these shares is disclaimed by George J. Coates.
- (2) As of April 8, 2016, George J. Coates owns 50,000 shares of Series A Preferred Stock and 4,514,341 shares of Series B Convertible Preferred Stock which entitles him to 500,000,000 and 4,514,341,000 votes, respectively, which when added to the votes from shares of common stock he holds brings his total number of votes at all matters brought before the common stockholders for a vote to 5,274,819,267, which represents an aggregate voting interest of 86.2%. Each share of Series B Convertible Preferred Stock becomes convertible into 1,000 shares of our common stock on the second anniversary of the date the shares of Series B Convertible Preferred Stock were issued.
- (3) As of April 8, 2016, Gregory G. Coates owns 311,023 shares of Series B Convertible Preferred Stock which entitles him to 311,023,000 votes, which when added to the votes from shares of common stock he holds brings his total number of votes at all matters brought before the common stockholders for a vote to 325,055,520, which represents an aggregate voting interest of 5.3%. Each share of Series B Convertible Preferred Stock becomes convertible into 1,000 shares of our common stock on the second anniversary of the date the shares of Series B Convertible Preferred Stock were issued.
- (4) As of April 8, 2016, Barry C. Kaye owns 24,147 shares of Series B Convertible Preferred Stock which entitles him to 24,147,000 votes, which when added to the votes from shares of common stock he holds brings his total number of votes at all matters brought before the common stockholders for a vote to 25,447,358 which represents an aggregate voting interest of 0.42%. Each share of Series B Convertible Preferred Stock becomes convertible into 1,000 shares of our common stock on the second anniversary of the date the shares of Series B Convertible Preferred Stock were issued.

## **Securities Authorized for Issuance under Equity Compensation Plans**

### **2006 Stock Option and Incentive Plan**

Our 2006 Stock Option and Incentive Plan (the "2006 Stock Plan") was adopted by our board of directors and by consent of George J. Coates, majority shareholder, was adopted by our shareholders. The 2006 Stock Plan provides for the grant of stock-based awards to employees, officers and directors of, and consultants or advisors to, the Company and its subsidiaries. Under the 2006 Stock Plan, we may grant options that are intended to qualify as incentive stock options ("incentive stock options") within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), options not intended to qualify as incentive stock options ("non-statutory options"), restricted stock and other stock-based awards. Incentive stock options may be granted only to our employees. A total of 12,500,000 shares of common stock may be issued upon the exercise of options or other awards granted under the 2006 Stock Plan. The maximum number of shares with respect to which awards may be granted in any calendar year to any employee under the 2006 Stock Plan shall not exceed 25% of the total number of shares authorized. All shares of common stock under this plan have been granted in the form of stock options.

### **2014 Stock Option and Incentive Plan**

The Company established a 2014 Stock Option and Incentive Plan (the "2014 Stock Plan") which was adopted by the Company's board on May 30, 2014 and by our shareholders on February 27, 2015 by consent of George J. Coates in his capacity as the majority stockholder. The 2014 Stock Plan provides for the grant of stock-based awards to employees, officers and directors of, and consultants or advisors to, the Company and its subsidiaries, if any. Under the 2014 Stock Plan, the Company may grant ISO's, non-statutory options, restricted stock and other stock-based awards. ISO's may be granted only to employees of the Company. A total of 50,000,000 shares of common stock may be issued upon the exercise of options or other awards granted under the 2014 Stock Plan. The maximum number of shares with respect to which awards may be granted during any one year to any employee under the 2014 Stock Plan shall not exceed 25% of the 50,000,000 shares of common stock authorized by the 2014 Stock Plan. At December 31, 2015, none of the shares of common stock authorized under the 2014 Stock Plan had been granted.

The 2006 Stock Plan and the 2014 Stock Plan (the "Stock Plans") are administered by the board and the Compensation Committee. Subject to the provisions of the Stock Plans, the board and the Compensation Committee each has the authority to select the persons to whom awards are granted and determine the terms of each award, including the number of shares of common stock subject to the award. Payment of the exercise price of an award may be made in cash, in a "cashless exercise" through a broker, or if the applicable stock option agreement permits, shares of common stock, or by any other method approved by the board or Compensation Committee. Unless otherwise permitted by the Company, awards are not assignable or transferable except by will or the laws of descent and distribution.

Upon the consummation of an acquisition of the business of the Company, by merger or otherwise, the board shall, as to outstanding awards (on the same basis or on different bases as the board shall specify), make appropriate provision for the continuation of such awards by the Company or the assumption of such awards by the surviving or acquiring entity and by substituting on an equitable basis for the shares then subject to such awards either (a) the consideration payable with respect to the outstanding shares of common stock in connection with the acquisition, (b) shares of stock of the surviving or acquiring corporation or (c) such other securities or other consideration as the board deems appropriate, the estimated fair market value of which (as determined by the board in its sole discretion) shall not materially differ from the estimated fair market value of the shares of common stock subject to such awards immediately preceding the acquisition. In addition to or in lieu of the foregoing, with respect to outstanding stock options, the board may, on the same basis or on different bases as the board shall specify, upon written notice to the affected optionees, provide that one or more options then outstanding must be exercised, in whole or in part, within a specified number of days of the date of such notice, at the end of which period such options shall terminate, or provide that one or more options then outstanding, in whole or in part, shall be terminated in exchange for a cash payment equal to the excess of the estimated fair market value (as determined by the board in its sole discretion) for the shares subject to such Options over the exercise price thereof. Unless otherwise determined by the board (on the same basis or on different bases as the board shall specify), any repurchase rights or other rights of the Company that relate to a stock option or other award shall continue to apply to consideration, including cash, that has been substituted, assumed or amended for a stock option or other award pursuant to these provisions. We may hold in escrow all or any portion of any such consideration in order to effectuate any continuing restrictions.

The board may at any time provide that any stock options shall become immediately exercisable in full or in part, that any restricted stock awards shall be free of some or all restrictions, or that any other stock-based awards may become exercisable in full or in part or free of some or all restrictions or conditions, or otherwise realizable in full or in part, as the case may be.

The board of directors or Compensation Committee may, in its sole discretion, amend, modify or terminate any award granted or made under the Stock Plan, so long as such amendment, modification or termination would not materially and adversely affect the participant.

The following table sets forth information with respect to our securities authorized for issuance as of April 8, 2016, under our 2006 and 2014 Stock Option and Incentive Plans:

	Number of securities to be issued upon exercise of outstanding options, rights and warrants	Weighted average exercise price of outstanding options, rights and warrants	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity Compensation plans approved by security holders:	12,500,000	\$ 0.182	50,000,000
Equity Compensation plans without approval by security holders	None	N/A	N/A
<b>Total</b>	<b>12,500,000</b>	<b>\$ 0.182</b>	<b>50,000,000</b>

No stock options or other stock-based awards have been granted under the 2014 Stock Option and Incentive Plan.

### Item 13. Certain Relationships and Related Transactions, and Director Independence.

#### Certain Relationships and Related Transactions

A related person is defined as any person who is (1) a director or executive officer of the registrant, (2) any nominee for director, (3) any immediate family member of a director or executive officer of the registrant or of any nominee for director, (4) any person who is known to the Company to be the beneficial owner of more than 5% of any class of the registrant's voting securities and (5) any immediate family of any person who is known to the Company to be the beneficial owner of more than 5% of any class of the registrant's voting securities.

#### Promissory Notes to Related Parties

##### *Promissory Notes due to George J. Coates*

During the year ended December 31, 2015, the Company issued, in a series of transactions, promissory notes to George J. Coates and received cash proceeds of \$70,000. During the years ended December 31, 2015 and 2014, the Company repaid promissory notes to George J. Coates in the aggregate principal amount of \$120,000 and \$200,000, respectively. The promissory notes are payable on demand and provide for interest at the rate of 17% per annum, compounded monthly.

During the period from March 28, 1991 through April 15, 1994, Mr. Coates made cash outlays of his own personal funds to acquire the Company's headquarters, research and development and warehouse facility amounting to \$950,000. Mr. Coates contributed this property to the Company and did not receive any consideration for this contribution. At that time, the \$950,000 purchase price was added to the Company's additional paid-in capital. Mr. Coates has been anticipating that these monies would be repaid to him at such time that the Company had sufficient working capital for this purpose. On April 28, 2014, the board of directors adopted a resolution to make a compensatory award of \$950,000 in the form of a non-interest bearing promissory note payable on demand due to Mr. Coates. The intent of this resolution was to compensate Mr. Coates for his lost benefits of ownership of the Company's headquarters, research and development and warehouse facility subsequent to the date he contributed this property. Mr. Coates offered to apply this amount towards the purchase of additional shares of the Company's common stock.

On April 29, 2014, the board of directors adopted another resolution to convert this non-interest bearing demand loan in the amount of \$950,000, along with \$50,000 of interest bearing, 17% promissory notes due to Mr. Coates into shares of the Company's common stock, bringing the total amount converted to \$1 million. The conversion price per share was determined to be equal to the closing trading price of the common stock on April 29, 2014. The closing trading price on that date was \$0.0252 per share. As a result of this resolution, 39,682,540 restricted shares of common stock were issued to Mr. Coates as of April 29, 2014.

In addition, during May 2014, by mutual consent between Mr. Coates and the Company, the remaining \$370,000 principal amount of the promissory notes due to Mr. Coates was converted into restricted shares of common stock of the Company at the closing price per share of \$0.029 on May 30, 2014. These promissory notes arose from cash lent to the Company for working capital purposes from Mr. Coates' personal funds. As a result, the Company issued 12,749,162 shares of restricted common stock to Mr. Coates. In September 2014, by mutual consent between Mr. Coates and the Company, a \$200,000 portion of the transaction converting promissory notes to common stock was rescinded. Accordingly, 6,896,552 shares of common stock were returned, cancelled and restored to authorized, unissued status and \$200,000 of promissory notes due to Mr. Coates was reinstated as a liability.

#### *Promissory Note Issued to Gregory G. Coates*

In a series of payments during the period from August 21, 1995 to February 14, 1996, Gregory G. Coates, President, Technology Division, director and son of George J. Coates, made cash outlays from his own personal funds on behalf of the Company in an amount which aggregated \$1,462,000 to provide needed working capital to the Company in order for it to continue its operations. Gregory G. Coates contributed these funds to the Company and did not receive any consideration for this contribution. At that time, the \$1,462,000 of cash outlays was added to the Company's additional paid-in capital. Gregory G. Coates has been anticipating that these monies would be repaid to him at such time that the Company had sufficient working capital for this purpose. Gregory G. Coates has requested that this amount of additional paid-in capital be converted into a non-interest bearing promissory note. On April 28, 2014, the board of directors adopted a resolution to convert \$1,462,000 of additional paid-in capital of the Company into a non-interest bearing promissory note payable on demand, due to Gregory G. Coates. As required by generally accepted accounting principles, interest at the rate of 10% per annum is being imputed on this note which aggregated \$145,000 for the year ended December 31, 2015.

During the year ended December 31, 2015 the Company made partial repayments of this non-interest bearing promissory note in the aggregate principal amount of \$23,623.

#### *Promissory Notes Issued to Bernadette Coates*

During the years ended December 31, 2015 and 2014 the Company repaid promissory notes in the aggregate principal amount of \$36,000 and \$81,000, respectively. The promissory notes were payable on demand and provided for interest at the rate of 17% per annum, compounded monthly.



### ***10% Convertible Note with a Related Party***

In June 2014, a 10% promissory note with a balance due of \$17,000, including accrued interest thereon, held by Dr. Michael J. Suchar, a former director, was converted into 612,664 restricted shares of common stock at a conversion price equal to the closing price of the common stock on the date of conversion of \$0.0285 per share.

### ***Share Issuances - Common Stock***

In a series of transactions throughout the year ended December 31, 2014, the Company made private sales, pursuant to stock purchase agreements of 16,456,076 unregistered shares of its common stock and 16,456,076 common stock warrants to purchase one restricted share of its common stock at exercise prices ranging from \$0.02 to \$0.04 per share in consideration for \$515,000 received from the son of Dr. Richard W. Evans, a former director. The proceeds were used for general working capital.

As discussed above under "Promissory Notes to Related Parties", in two transactions during April and May 2014, 17% promissory notes due to George J. Coates having a principal balance of \$420,000 were converted into 14,733,289 restricted shares of common stock at an average price per share of \$0.0285. In August 2014, the conversion of \$200,000 of these 17% promissory notes was rescinded.

As discussed above under "Promissory Notes to Related Parties", in 2014, a non-interest bearing promissory note due to George J. Coates in the principal amount of \$950,000 was converted into 37,698,413 restricted shares of common stock at an average price per share of \$0.0252.

### ***Share Issuances - Series A Preferred Stock***

During the period from January 1, 2014 to July 2, 2014, 40,191 of Series A were granted and issued to George J. Coates pursuant to an anti-dilution agreement. On July 3, 2014 all of the 181,664 shares of Series A previously issued to George J. Coates were converted into shares of Series B Convertible Preferred Stock, \$0.001 par value per share ("Series B"). At the same time, the aforementioned anti-dilution protection for Mr. Coates, pursuant to which shares of Series A may be issued, was cancelled and replaced with a new anti-dilution protection arrangement which involves the issuance of shares of Series B. On August 1, 2014, 50,000 shares of Series A with an estimated fair value of \$69,000 were issued to George J. Coates as an inducement to him to consider future offers from investors to acquire substantial ownership interests in the Company as a means of raising substantial new working capital for the Company. At December 31, 2015, Mr. Coates held all 50,000 shares of Series A outstanding, which entitle him to 500 million votes in addition to his voting rights from the shares of common stock and the shares of Series B he holds.

### ***Share Issuances - Series B Convertible Preferred Stock***

On July 3, 2014, the board of directors consented to (i) the conversion of all of the 181,664 shares of Series A held by George J. Coates into shares of Series B at a conversion rate of one share of Series B for each share of Series A, (ii) an anti-dilution award of an additional 75,000 shares of Series B to Mr. Coates, and (iii) a modified anti-dilution plan, effective as of July 3, 2014 (the "Modified Plan") for George J. Coates.

The anti-dilution award of an additional 75,000 shares of Series B to Mr. Coates was determined to be the number of shares of Series B required to restore Mr. Coates' ownership percentage of outstanding common stock on a pro forma basis to 78%, assuming all of the Series B shares were converted into common stock. The ownership percentage of 78% represents the percentage of outstanding common stock that Mr. Coates originally held at December 31, 2002.

Under the Modified Plan, for each new share of common stock issued by the Company to non-Coates family members in the future, additional shares of Series B will be issued to Mr. Coates equal to that number of shares of Series B required to maintain his ownership percentage of outstanding shares of common stock outstanding on a pro forma basis, at 78%.

These anti-dilution provisions do not apply to new shares of common stock issued in connection with exercises of employee stock options, a secondary public offering of the Company's securities or a merger or acquisition.

On July 28, 2014, the board of directors consented to an anti-dilution program which provides that shares of Series B be issued to Gregory G. Coates whenever new shares of common stock are issued to non-Coates family members in order to maintain his ownership percentage of common stock at 5.31% of the pro forma number of shares of common stock outstanding, assuming all shares of Series B were converted to common stock. This was his percentage ownership of common stock at December 31, 2002.

On July 28, 2014, the board of directors consented to an anti-dilution program which provides that shares of Series B be issued to Barry C. Kaye whenever new shares of common stock are issued to non-Coates family members in order to maintain his ownership percentage of common stock at 0.04157% of the pro forma number of shares of common stock outstanding, assuming all shares of Series B were converted to common stock. This was the weighted average percentage ownership of common stock he purchased, based on the number of shares of common stock outstanding on each date he acquired additional shares of common stock.

The issuance of these shares of Series B to Gregory G. Coates and Barry C. Kaye triggered the issuance of an additional 115,006 shares of Series B to George J. Coates in 2014, in accordance with the anti-dilution program in effect for George J. Coates.

Under this new anti-dilution Plan, for each new share of common stock issued by the Company to non-Coates family members in the future, additional shares of Series B will be issued to Gregory G. Coates and Barry C. Kaye equal to that number of shares of Series B required to maintain their ownership percentage of outstanding shares of common stock outstanding on a pro forma basis, at 5.31% and 0.04157, respectively.

As a result of the new anti-dilution arrangements put into place during 2014, the number of shares of Series B outstanding at December 31, 2015 totaled 3,492,749 consisting of 3,250,363, 224,975 and 17,411 shares held by George J. Coates, Gregory G. Coates and Barry C. Kaye, respectively. Each share of Series B Convertible Preferred Stock becomes convertible into 1,000 shares of common stock at any time after the second anniversary after the date of issuance.

#### ***Stock Option Grants***

During the year ended December 31, 2014, options to purchase 351,500 and 351,500 shares of common stock at an exercise price of \$0.028 per share were granted to Gregory G. Coates and Barry C. Kaye, respectively. The stock options fully vested in April 2015. The estimated fair value of stock options granted was \$9,837 and \$9,837, respectively.

#### ***Compensation***

For the years ended December 31, 2015 and 2014, George J. Coates earned base compensation of \$250,000 and \$250,000, respectively, payment of which has been deferred until the Company has sufficient working capital.

For the years ended December 31, 2015 and 2014, Bernadette Coates, spouse of George J. Coates, earned base compensation of \$67,240 and \$67,240, respectively, payment of which has been deferred until the Company has sufficient working capital.

For the years ended December 31, 2015 and 2014, Gregory G. Coates earned base compensation of \$155,769 and \$161,539, respectively. The compensation in 2015 and 2014 included payment for vacation earned, but not taken.

#### ***Consulting Fees***

During the year ended December 31, 2015 and 2014, Barry C. Kaye, Treasurer and Chief Financial Officer was paid compensation of \$83,000 and \$170,000, respectively. For the year ended December 31, 2015, Mr. Kaye earned compensation of \$106,400 which has not been paid and is being deferred until the Company has sufficient working capital to remit payment to him.

### ***Personal Guaranty and Pledge of Stock***

The Company's mortgage loan on its headquarters is collateralized by the pledge of five million shares of common stock of the Company owned by George J. Coates, which were deposited into escrow for the benefit of the lender and by his personal guaranty.

### **Director Independence**

We have used the definition of "independence" contained in the listing rules of The NASDAQ Stock Market to make the determination as to whether or not our directors are independent, because our common stock is not currently listed on a national securities exchange. NASDAQ Listing Rule 5605(a)(2) provides that an "independent director" is a person other than an officer or employee of the Company or any other individual having a relationship which, in the opinion of the Company's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. The NASDAQ listing rules provide that a director cannot be considered independent if:

- the director is, or at any time during the past three years was, an employee of the company;
- the director or a family member of the director accepted any compensation from the company in excess of \$120,000 during any period of 12 consecutive months within the three years preceding the independence determination (subject to certain exclusions, including, among other things, compensation for board or board committee service);
- a family member of the director is, or at any time during the past three years was, an executive officer of the company;
- the director or a family member of the director is a partner in, controlling stockholder of, or an executive officer of an entity to which the company made, or from which the company received, payments in the current or any of the past three fiscal years that exceed 5% of the recipient's gross revenue for that year or \$200,000, whichever is greater (subject to certain exclusions);
- the director or a family member of the director is employed as an executive officer of an entity where, at any time during the past three years, any of the executive officers of the company served on the compensation committee of such other entity; or the director or a family member of the director is a current partner of the company's outside auditor, or at any time during the past three years was a partner or employee of the company's outside auditor, and who worked on the company's audit.

The following table sets forth the members of our board of directors that are independent and certain board committee assignments:

Dr. Frank Adipietro	Director *, **
Jack Perkowski	Director *, ***
Richard Whitworth	Director *, **, ***

\* Serves as an independent director.

\*\* Serves as a member of our compensation committee.

\*\*\* Serves as a member of our audit committee.

### **Item 14. Principal Accounting Fees and Services.**

#### *Audit Fees*

During the year ended December 31, 2015, Cowan billed us in the aggregate \$74,000 for professional services rendered for their audit of our annual financial statements for the years ended December 31, 2014, included in our Form 10-K and their reviews of the quarterly financial statements included in our Forms 10-Q for each of the three quarters in 2015.

During the year ended December 31, 2014, Cowan billed us in the aggregate \$75,500 for professional services rendered for their audit of our annual financial statements for the year ended December 31, 2013, included in our Form 10-K and their reviews of the quarterly financial statements included in our Forms 10-Q for each of the three quarters in 2014.

*Audit-related Fees*

For the year ended December 31, 2015, Cowan billed us \$16,383 in connection with providing their consent to the inclusion of our audited financial statements in a registration statement and the amendments thereto on Form S-1.

For the year ended December 31, 2014, Cowan billed us \$5,600 in connection with providing their consent to the inclusion of our audited financial statements in a registration statement and the amendments thereto on Form S-1.

*Tax Fees*

Cowan did not provide any tax-related services in the years ended December 31, 2015 and 2014.

*All Other Fees*

The Company did not incur any other fees related to services rendered by our principal auditor for the fiscal years ended December 31, 2015 and 2014.

The Securities and Exchange Commission adopted rules which require that before our auditor is engaged by us to render any auditing or permitted non-audit related service, the engagement be:

- approved by our audit committee; or
- entered into pursuant to pre-approval policies and procedures established by the audit committee, provided the policies and procedures are detailed as to the particular service, the audit committee is informed of each service, and such policies and procedures do not include delegation of the audit committee's responsibilities to management.

All of the above services were approved in accordance with the above adoptive rules of the Securities and Exchange Commission.

## PART IV

### Item 15. Exhibits, Financial Statement Schedules.

#### (a) Documents Filed as Part of this Report.

(1) Financial Statements.

Audited financial statements of Coates International, Inc. as of December 31, 2015 and 2014 and for the years then ended are presented beginning on page F-1.

(2) Financial Statement Schedules.

None

(3) Exhibits

<b>Exhibit No.</b>	<b>Description</b>
3.1 <sup>(1)</sup>	Restated Certificate of Incorporation
3.1(i) <sup>(1)</sup>	Certificate of Amendment to Certificate of Incorporation filed with the Secretary of State of Delaware on May 22, 2000
3.1(ii) <sup>(1)</sup>	Certificate of Amendment to Certificate of Incorporation filed with the Secretary of State of Delaware on August 31, 2001
3.1(iii) <sup>(2)</sup>	Certificate of Amendment to Certificate of Incorporation filed with the Secretary of State of Delaware on September 12, 2007
3.1(iv) <sup>(3)</sup>	Certificate of Amendment of Certificate of Incorporation filed with the Secretary of State of Delaware, dated May 29, 2015
3.2 <sup>(1)</sup>	Bylaws
4.1 <sup>(4)</sup>	Certification of Designation of Series A Preferred Stock, effective April 30, 2009
4.2 <sup>(4)</sup>	Certificate of Amendment of Certification of Designation of Series A Preferred Stock, effective May 24, 2011
4.3 <sup>(5)</sup>	Certificate of Designation, Preferences and Rights of Series B Convertible Preferred Stock, dated January 14, 2014
4.4 <sup>(6)</sup>	Certificate of Amendment of Designation of Series B Convertible Preferred Stock, dated March 9, 2015
10.1 <sup>(7)</sup>	License Agreement, dated September 29, 1999, with Well to Wire Energy, Inc.
10.2 <sup>(7)</sup>	Amendment No. 1 to License Agreement with Well to Wire Energy Inc. dated April 6, 2000
10.3 <sup>(7)</sup>	Amendment No. 2 to License Agreement with Well to Wire Energy Inc. dated July 21, 2000
10.4 <sup>(8)</sup>	2006 Employee Stock Option and Incentive Plan adopted on October 25, 2006

- 10.5<sup>(9)</sup> Amended and Restated License Agreement between the Company and George J. Coates and Gregory G. Coates dated April 6, 2007
- 10.6<sup>(10)</sup> Cooperation Agreement executed June 16, 2010 between the Company and Tongji University of China
- 10.7<sup>(11)</sup> Placement Agency Agreement between the Company and Stonegate Securities, Inc. dated December 21, 2007
- 10.8<sup>(12)</sup> License Agreement between the Company and Well to Wire Energy, Inc. dated January 29, 2008 and executed on April 7, 2008
- 10.9<sup>(12)</sup> Escrow Agreement between the Company and Well to Wire Energy, Inc. dated April 11, 2008
- 10.10<sup>(13)</sup> Memorandum of Understanding dated February 8, 2010 among the Company, Well to Wire Energy, Inc. and Almont Energy, Inc. covering the consent of the Company to the assignment of the Canadian License, Research and Development Agreement, Rights to the US Licensing Agreement and the Right of First Refusal.
- 10.11<sup>(14)</sup> Letter from Cummins confirming supply arrangement with Coates International, Ltd.
- 10.12<sup>(15)</sup> Sale/leaseback Agreement with Paradigm Commercial Capital Group, dated August 15, 2013
- 10.13<sup>(16)</sup> Equity Purchase Agreement between the Company and Southridge Partners II LP, dated July 2, 2014.
- 10.14<sup>(16)</sup> Registration Rights Agreement between the Company and Southridge Partners II LP, dated July 2, 2014.
- 10.15<sup>(16)</sup> 2014 Employee Stock Option and Incentive Plan adopted on May 31, 2014
- 10.16<sup>(17)</sup> License Agreement between the Company and Renown Power Development, Ltd., executed February 24, 2015.
- 10.17<sup>(18)</sup> Convertible Promissory Note Issued to Vis Vires Group, Inc., dated June 12, 2015
- 10.18<sup>(18)</sup> Securities Purchase Agreement Between the Company and Vis Vires Group, Inc., dated June 12, 2015
- 10.19<sup>(19)</sup> Equity Purchase Agreement between the Company and Southridge Partners II LP, dated July 29, 2015
- 10.20<sup>(19)</sup> Registration Rights Agreement between the Company and Southridge Partners II LP, dated July 29, 2015
- 10.21<sup>(20)</sup> Secured Convertible Promissory Notes issued to Typenex Co-Investment, LLC, dated August 14, 2015
- 10.22<sup>(20)</sup> Securities Purchase Agreement Between the Company and Typenex Co-Investment, LLC, dated J August 14, 2015
- 10.23<sup>(21)</sup> Convertible Promissory Note Issued to Kris Iyer, Dated September 11, 2015.

10.24 <sup>(21)</sup>	Securities Purchase Agreement Between the Company and Kris Iyer, Dated September 11, 2015
10.25 <sup>(22)</sup>	Convertible Promissory Note Issued to Vis Vires Group, Inc., dated September 16, 2015
10.26 <sup>(22)</sup>	Securities Purchase Agreement Between the Company and Vis Vires Group, Inc., dated September 16, 2015
10.27 <sup>(23)</sup>	Convertible Promissory Note Issued to JMJ Financial, dated November 10, 2015
10.28 <sup>(24)</sup>	Convertible Promissory Note Issued to GW Holdings Group, dated January 4, 2016
10.29 <sup>(24)</sup>	Securities Purchase Agreement Between the Company and GW Holdings Group, dated January 4, 2016
10.30 <sup>(27)</sup>	Convertible Promissory Note Issued to APG Capital Holding, LLC dated January 4, 2016
10.31 <sup>(27)</sup>	Securities Purchase Agreement Between the Company and APG Capital Holding, LLC, dated February 12, 2016
31.1 <sup>(28)</sup>	Certification of Principal Executive Officer, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2 <sup>(28)</sup>	Certification of Principal Financial Officer, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1 <sup>(28)</sup>	Certification of Principal Executive Officer Pursuant To 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2 <sup>(28)</sup>	Certification of Principal Financial Officer, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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- (1) Incorporated by reference from the Company's Registration Statement filed May 31, 2007 on Form SB-2 with the Securities and Exchange Commission, File No. 333-143406.
  - (2) Incorporated by reference from the Company's Schedule 14C DEF filed with the Securities and Exchange Commission on October 1, 2007.
  - (3) Incorporated by reference from the Company's Registration Statement filed July 30, 2015 on Form S-1 with the Securities and Exchange Commission, File No. 333-205959.
  - (4) Incorporated by reference from the Company's Form 10-K filed with the Securities and Exchange Commission on April 16, 2013.

- (5) Incorporated by reference from the Company's Form 10-K filed with the Securities and Exchange Commission on March 31, 2014.
- (6) Incorporated by reference from the Company's Form 10-K filed with the Securities and Exchange Commission on March 31, 2015.
- (7) Incorporated by reference from the Company's Registration Statement and amendments thereto filed September 11, 2001 on Form 10-SB12G with the Securities and Exchange Commission, File No. 000-33155.
- (8) Incorporated by reference from the Company's Form 10-KSB/A for the year ended December 31, 2005 filed on October 25, 2006.
- (9) Incorporated by reference from the Company's Form 10-KSB for the year ended December 31, 2006.
- (10) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2010.
- (11) Incorporated by reference from the Company's Form 8-K filed with the Securities and Exchange Commission on January 3, 2008.
- (12) Incorporated by reference from the Company's Form 8-K filed with the Securities and Exchange Commission on April 11, 2008.
- (13) Incorporated by reference from the Company's Form 10-K for the year ended December 31, 2009.
- (14) Incorporated by reference to the Company's Registration Statement on Form S-1 filed on June 24, 2011.
- (15) Incorporated by reference from the Company's Form 10-Q filed with the Securities and Exchange for the quarter ended September 30, 2013.
- (16) Incorporated by reference from the Company's Form S-1 filed with the Securities and Exchange Commission on August 19, 2014.
- (17) Incorporated by reference from the Company's Form 10-K for the fiscal year ended December 31, 2014.
- (18) Incorporated by reference from the Company's Form 8-K filed with the Securities and Exchange Commission on June 19, 2015.
- (19) Incorporated by reference from the Company's Form S-1 filed with the Securities and Exchange Commission on July 30, 2015.
- (20) Incorporated by reference from the Company's Form 8-K filed with the Securities and Exchange Commission on August 20, 2015.
- (21) Incorporated by reference from the Company's Form 8-K filed with the Securities and Exchange Commission on September 15, 2015.
- (22) Incorporated by reference from the Company's Form 8-K filed with the Securities and Exchange Commission on September 22, 2015.
- (23) Incorporated by reference from the Company's Form 10-Q filed with the Securities and Exchange Commission for the quarter ended September 30, 2015.
- (24) Incorporated by reference from the Company's Form 8-K filed with the Securities and Exchange Commission on January 8, 2016.
- (25) Incorporated by reference from the Company's Form 10-K filed with the Securities and Exchange Commission or the year ended December 31, 2012.
- (26) Incorporated by reference from the Company's Form 10-K filed with the Securities and Exchange Commission or the year ended December 31, 2013.
- (27) Filed herewith.
- (28) In accordance with SEC Release 33-8238, Exhibit 32.1 and 32.2 are being furnished and not filed.



## SIGNATURES

Pursuant to the requirement of Section 13 or 15(d) 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, on April 14, 2016.

COATES INTERNATIONAL, LTD.

By: /s/ George J. Coates  
George J. Coates,  
Chairman and Chief Executive Officer

By: /s/ Barry C. Kaye  
Barry C. Kaye,  
Chief Financial Officer

Pursuant to the requirement of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ George J. Coates</u> George J. Coates	Director, Chairman, Chief Executive Officer and President (principal executive officer)	April 14, 2016
<u>/s/ Gregory G. Coates</u> Gregory G. Coates	Director, Secretary and President-Technology Division	April 14, 2016
<u>/s/ Barry C. Kaye</u> Barry C. Kaye	Director, Treasurer, Chief Financial Officer (principal financial and accounting officer)	April 14, 2016
<u>/s/ John Perkowski</u> John Perkowski	Director	April 14, 2016
<u>/s/ Frank J. Adipietro</u> Frank J. Adipietro	Director	April 14, 2016
<u>/s/ Richard Whitworth</u> Richard Whitworth	Director	April 14, 2016

**Coates International, Ltd.**  
**Index to Financial Statements**  
**December 31, 2015 and 2014**

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COWAN, GUNTESKI & CO., P.A.  
CERTIFIED PUBLIC ACCOUNTANTS  
730 HOPE ROAD  
TINTON FALLS, NJ 07724

Report of Independent Registered Public Accounting Firm

To the Board of Directors and  
Stockholders of Coates International, Ltd.

We have audited the accompanying balance sheets of Coates International, Ltd. as of December 31, 2015 and 2014, and the related statements of operations, stockholders' deficiency, and cash flows for the years ended December 31, 2015 and 2014. Coates International, Ltd.'s management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Coates International, Ltd. as of December 31, 2015 and 2014, and the results of its operations and its cash flows for the years ended December 31, 2015 and 2014, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the financial statements, the Company continues to have negative cash flows from operations, recurring losses from operations, and a stockholders' deficiency. These conditions raise substantial doubt about its ability to continue as a going concern. Management's plans regarding these matters are also described in Note 1. The financial statements do not include any adjustments that may result from the outcome of this uncertainty.

/s/ Cowan, Gunteski & Co., P.A.

Tinton Falls, New Jersey  
April 14, 2016

Coates International, Ltd.  
Balance Sheets  
As of December 31,

	<u>2015</u>	<u>2014</u>
<b>Assets</b>		
<b>Current Assets</b>		
Cash	\$ 29,207	\$ 263,526
Inventory, net	218,018	47,274
Deferred offering costs and other assets	9,117	44,874
Total Current Assets	<u>256,342</u>	<u>355,674</u>
Property, plant and equipment, net	2,108,990	2,119,010
Deferred licensing costs, net	42,449	46,732
Total Assets	<u>\$ 2,407,781</u>	<u>\$ 2,521,416</u>
<b>Liabilities and Stockholders' Deficiency</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued liabilities	\$ 2,022,568	\$ 1,982,777
Promissory notes to related parties	1,455,882	1,565,505
Deferred compensation payable	922,144	1,079,904
Derivative liability related to convertible promissory notes	632,927	475,695
Convertible promissory notes, net of unamortized discount	408,110	500,905
Deposits	150,595	19,124
Current portion of license deposits	60,725	517,500
Current portion of mortgage loan payable	60,000	1,448,284
Current portion of finance lease obligation, net of unamortized discount	19,349	62,102
Total Current Liabilities	<u>5,732,300</u>	<u>7,651,796</u>
Non-current portion of mortgage loan payable	1,328,159	-
Non-current portion of license deposits	646,375	283,800
Non-current portion of finance lease obligation, net of unamortized discount	-	19,349
Total Liabilities	<u>7,706,834</u>	<u>7,954,945</u>
Commitments and Contingencies	-	-
<b>Stockholders' Deficiency</b>		
Preferred stock, \$0.001 par value, 100,000,000 shares authorized:		
Series A Preferred Stock, 1,000,000 shares designated, 50,000 shares issued and outstanding at December 31, 2015 and 2014	50	50
Series B Convertible Preferred Stock, 5,000,000 and 1,000,000 shares designated, 3,492,749 and 585,502 shares issued and outstanding at December 31, 2015 and 2014	3,493	586
Common Stock, \$0.0001 par value, 2,000,000,000 shares authorized, 1,036,791,116 shares issued and outstanding at December 31, 2015 and 1,000,000,000 shares authorized, 443,508,090 shares issued and outstanding at December 31, 2014	103,679	44,351
Additional paid-in capital	51,564,723	41,288,663
Accumulated deficit	(56,970,998)	(46,767,179)
Total Stockholders' Deficiency	<u>(5,299,053)</u>	<u>(5,433,529)</u>
Total Liabilities and Stockholders' Deficiency	<u>\$ 2,407,781</u>	<u>\$ 2,521,416</u>

The accompanying notes are an integral part of these financial statements.

Coates International, Ltd.  
Statements of Operations

	For the Years Ended December 31,	
	2015	2014
Sublicensing fee revenue	\$ 94,200	\$ 19,200
Total Revenues	<u>94,200</u>	<u>19,200</u>
Expenses:		
Marketing expenses	6,864	48,095
Research and development costs	417,145	487,767
Compensation and benefits	7,852,456	10,400,971
General and administrative expenses	532,680	575,235
Depreciation and amortization	52,552	64,920
Total Operating Expenses	<u>8,861,697</u>	<u>11,576,988</u>
Loss from Operations	<u>(8,767,497)</u>	<u>(11,557,788)</u>
Other Expense:		
Increase in estimated fair value of embedded derivative liabilities	(157,232)	(109,105)
Loss on conversion of convertible notes	(273,160)	(94,632)
Interest expense	(1,005,930)	(1,028,343)
Total other expense	<u>(1,436,322)</u>	<u>(1,232,080)</u>
Loss Before Income Taxes	<u>(10,203,819)</u>	<u>(12,789,868)</u>
Provision for income taxes	-	-
Net Loss	<u>\$ (10,203,819)</u>	<u>\$ (12,789,868)</u>
Basic net loss per share	<u>\$ (0.01)</u>	<u>\$ (0.03)</u>
Basic weighted average shares outstanding	<u>799,640,609</u>	<u>385,372,919</u>
Diluted net loss per share	<u>\$ (0.01)</u>	<u>\$ (0.03)</u>
Diluted weighted average shares outstanding	<u>799,640,609</u>	<u>385,372,919</u>

The accompanying notes are an integral part of these financial statements.

Coates International, Ltd.  
 Statements of Stockholders' Deficiency  
 For the Years Ended December 31, 2015

	Series A Preferred Stock, \$0.001 par value per share		Series B Preferred Stock, \$0.001 par value per share		Common Stock, \$0.0001 par value per share		Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Deficiency
	Shares	Amount	Shares	Amount	Shares	Amount			
Balance, January 1, 2014	141,473	\$ 141	-	\$ -	327,749,176	\$ 32,775	\$30,712,778	\$(33,977,311)	\$ (3,231,617)
Issuance of anti-dilution shares of Series A Preferred stock to George J. Coates	90,191	90					169,362		169,452
Conversion of Series A Preferred Stock held by George J. Coates into Series B Convertible Preferred Stock	(181,664)	(181)	256,664	257			4,050,993		4,051,069
Issuance of anti-dilution shares of Series B Convertible Preferred Stock to related parties			328,838	329			4,511,342		4,511,671
Conversion of convertible promissory notes					48,251,621	4,825	621,960		626,785
Stock-based compensation award to George J. Coates for lost benefits of property ownership					37,698,413	3,770	946,230		950,000
Issuance of common stock and warrants to son of a director					16,456,076	1,646	513,354		515,000
Conversion of promissory notes to related parties into common stock					8,449,401	845	236,342		237,187
Issuance of common stock under equity line of credit with Dutchess Opportunity Fund II, LP					4,403,403	440	161,196		161,636
Exercise of stock purchase warrants					500,000	50	9,950		10,000
Conversion of additional paid-in capital into note due to related party							(1,462,093)		(1,462,093)
Beneficial conversion feature on convertible promissory notes							800,182		800,182
Stock-based compensation expense							17,067		17,067
Net loss for the year								(12,789,868)	(12,789,868)
Balance, December 31, 2014	<u>50,000</u>	<u>50</u>	<u>585,502</u>	<u>586</u>	<u>443,508,090</u>	<u>44,351</u>	<u>41,288,663</u>	<u>(46,767,179)</u>	<u>(5,433,529)</u>
Issuance of Anti-dilution shares of Series B Convertible Preferred Stock to Related Parties			2,907,247	2,907			8,040,040		8,042,947
Conversion of Convertible Promissory Notes					520,777,116	52,078	922,447		974,525
Issuance of common stock under equity purchase agreement with Southridge Partners II, LP					72,505,910	7,250	400,011		407,261
Beneficial Conversion Feature on Convertible Promissory Notes							761,563		761,563
Imputed interest on non-interest bearing promissory note to related party							145,443		145,443
Stock-based compensation expense							6,556		6,556
Net loss for the year								(10,203,819)	(10,203,819)
Balance, December 31, 2015	<u>50,000</u>	<u>\$ 50</u>	<u>3,492,749</u>	<u>\$ 3,493</u>	<u>1,036,791,116</u>	<u>\$ 103,679</u>	<u>\$51,564,723</u>	<u>\$(56,970,998)</u>	<u>\$ (5,299,053)</u>

The accompanying notes are an integral part of these financial statements.

Coates International Ltd.  
Statements of Cash Flows

	For the Years Ended December 31,	
	2015	2014
<b>Net Cash Flows Used in Operating Activities</b>		
Net loss for the year	\$ (10,203,819)	\$ (12,789,868)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	7,574,503	10,174,258
Interest accrued, but not paid	878,251	736,622
Increase in fair value of embedded derivative liabilities	157,232	109,105
Loss on conversion of convertible notes	273,160	94,632
Depreciation and amortization	52,552	64,920
Non-cash portion of inventory used for research and development	45,240	-
Amortization of deferred financing costs	-	10,246
Negotiated settlement of accounts payable	-	(20,266)
Recognition of non-cash licensing revenues	(94,200)	(19,200)
Changes in Operating Assets and Liabilities:		
Inventory, net	(170,744)	64,478
Deferred offering costs and other assets	35,757	(32,451)
Accounts payable and accrued liabilities	54,127	(281,170)
Deferred compensation payable	317,240	317,240
Deposit with order	131,471	-
<b>Net Cash Used in Operating Activities</b>	<b>(949,230)</b>	<b>(1,571,454)</b>
<b>Net Cash Used in Investing Activities:</b>		
Acquisition of property, plant and equipment	(38,249)	-
<b>Cash Flows Provided by Financing Activities:</b>		
Issuance of convertible promissory notes	630,500	995,583
Issuance of common stock under equity purchase agreements	407,261	515,000
Issuance of promissory notes to related parties	70,000	498,300
Issuance of common stock under equity line of credit	-	161,636
Proceeds from exercise of stock warrants	-	10,000
Repayment of promissory notes to related parties	(179,623)	-
Repayment of convertible promissory notes	(52,750)	(280,000)
Finance Lease Obligation Payments	(62,102)	(65,000)
Repayment of mortgage loan	(60,126)	(49,813)
<b>Net Cash Provided by Financing Activities</b>	<b>753,160</b>	<b>1,785,706</b>
Net (Decrease) Increase in Cash	(234,319)	214,252
Cash, beginning of period	263,526	49,274
Cash, end of period	\$ 29,207	\$ 263,526
<b>Supplemental Disclosure of Cash Flow Information:</b>		
Cash paid during the year for interest	\$ 190,682	\$ 165,555
<b>Supplemental Disclosure of Non-cash Financing Activities:</b>		
Conversion of convertible promissory notes	\$ 978,209	\$ 626,785
Conversion of additional paid in capital into promissory note to Gregory Coates	-	1,462,093
Conversion of Promissory Notes to Related Parties into Common Stock	-	219,726
	\$ 978,209	\$ 2,308,604

The accompanying notes are an integral part of these financial statements.

## 1. THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### *Nature of Organization*

Coates International, Ltd. is a Delaware corporation organized in October 1991 as successor-in-interest to a Delaware corporation of the same name incorporated in August 1988. Coates International, Ltd. operates in Wall Township, New Jersey.

The Company has acquired the exclusive licensing rights for the Coates spherical rotary valve (“CSR<sup>®</sup>”) system technology in North America, Central America and South America (the “CSR<sup>®</sup> License”). The CSR<sup>®</sup> system technology has been developed over a period of more than 20 years by the Company’s founder George J. Coates and his son Gregory G. Coates. The CSR<sup>®</sup> system technology is adaptable for use in piston-driven internal combustion engines of many types and has been patented in the United States and numerous countries throughout the world.

The CSR<sup>®</sup> system technology is designed to replace the intake and exhaust conventional “poppet valves” currently used in almost all piston-driven, automotive, truck, motorcycle, marine and electric power generator engines, among others. Unlike conventional valves which protrude into the engine cylinder, the CSR<sup>®</sup> system technology utilizes spherical valves that rotate in a cavity formed between a two-piece cylinder head. The CSR<sup>®</sup> system technology utilizes significantly fewer moving parts than conventional poppet valve assemblies. As a result of these design improvements, management believes that engines incorporating the CSR<sup>®</sup> system technology (“Coates Engines<sup>®</sup>”) will last significantly longer and will require less lubrication over the life of the engine, as compared to conventional engines. In addition, CSR<sup>®</sup> Engines can be designed with larger openings into the engine cylinder than with conventional valves so that more fuel and air can be inducted into, and expelled from, the cylinder in a shorter period of time. Larger valve openings permit higher revolutions-per-minute (RPM’s) and permit higher compression ratios with lower combustion chamber temperatures, allowing the Coates Engine<sup>®</sup> to produce more power than equivalent conventional engines. The extent to which higher RPM’s, greater volumetric efficiency and thermal efficiency can be achieved with the CSR<sup>®</sup> system technology, is a function of the engine design and application.

### *Hydrogen Reactor Technology Owned by George J. Coates*

George J. Coates has developed a hydrogen reactor which rearranges H<sub>2</sub>O water molecules into HOH molecules also known as Hydroxy-Gas. The Hydroxy-Gas produced by the hydrogen reactor is then harvested for use as a type of fuel. Mr. Coates intends to continue with development of this technology to enable the harvested Hydroxy-Gas to be utilized as the fuel source to power our patented CSR<sup>®</sup> engines. The next phase of this research and development will focus on powering larger, industrial engines. If successful, this application will only require a ready supply of water and would be suitable for stationary engines and generators. Conventional internal combustion engines employing poppet valve assemblies require lubrication and would experience excessive heat and friction if powered with Hydroxy-Gas. This, in turn, would cause the engines to burn out in a rather short period of time. The materials and components of the CSR<sup>®</sup> engines do not require such lubrication and because of their design, are able to operate relatively trouble-free on Hydroxy-Gas as the engine fuel. There can be no assurance that this technology can be developed successfully, or that if developed, it will be feasible to penetrate the internal combustion engine market with this technology.

The Company and WTF Asia International Ltd., a Hong Kong-based entity have agreed to work together to develop this technology to enable it to be applied to large industrial gen set engines. The Company has fulfilled its obligations under this joint project by designing and integrating the switchgears, controls, load bank and emission equipment into the hydrogen reactor/gen set (“Coates Assembled Components”). On the basis of a verbal agreement, WTF Asia International Ltd. (“WTF”) is currently building additional components based on technology already developed that will enable the hydrogen reactor to adequately power larger commercial and industrial engines. Upon completion of the WTF deliverable, the parties intend to enter into a formal agreement and the WTF technology will be integrated with the Coates Assembled Components resulting in a CSR<sup>®</sup> hydrogen powered gen set.



Coates International, Ltd.  
Notes to Financial Statements - (Continued)

Applications for patent protection of this technology will be filed upon completion of the research and development. Although at this time no arrangements have been made between the Company and George J. Coates, owner of the technology, regarding licensing of the hydrogen reactor, Mr. Coates has provided his commitment to license this technology to the Company once the related patent protection is in place. Accordingly, the Company does not currently have any rights to manufacture, use, sell and distribute the Hydrogen Reactor technology, should it become commercially feasible to manufacture and distribute products powered by the Hydroxy-Gas fuel. The Company has been and continues to be responsible for all costs incurred related to the development of this technology.

*Basis of Presentation*

The accompanying financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") and rules and regulations of the Securities and Exchange Commission (the "SEC").

Since the Company's inception, the Company has been responsible for the development costs of the CSRV<sup>®</sup> technology in order to optimize the value of the licensing rights and has incurred related operational costs, the bulk of which have been funded primarily through cash generated from licensing fees, sales of stock, short term convertible promissory notes, capital contributions, loans made by George J. Coates, Bernadette Coates, his spouse and certain directors, fees received from research and development of prototype models and a small number of CSRV<sup>®</sup> engine generator sales. The Company has incurred substantial cumulative losses from operations since its inception. Losses from operations are expected to continue until the Coates Engines<sup>®</sup> are successfully introduced into and accepted in the marketplace, or the Company receives substantial licensing revenues. These losses from operations were substantially related to research and development of the Company's intellectual property rights, patent filing and maintenance costs and general and administrative expenses. The Company has also incurred substantial non-cash expenses for stock-based compensation and related to convertible promissory notes.

As shown in the accompanying financial statements, the Company has incurred recurring losses from operations and, as of December 31, 2015, had a stockholders' deficiency of (\$5,229,000). In addition, the current economic environment, which is characterized by tight credit markets, investor uncertainty about how to safely invest their funds and low investor confidence, has introduced additional risk and difficulty to the Company's challenge to secure needed additional working capital. These factors raise substantial doubt about the Company's ability to continue as a going concern. Management has instituted a cost control program intended to restrict variable costs to only those expenses that are necessary to complete its activities related to entering the production phase of operations, develop additional commercially feasible applications of the CSRV<sup>®</sup> system technology, seek additional sources of working capital and cover general and administrative costs in support of such activities. The Company has been actively undertaking efforts to secure new sources of working capital. At the December 31, 2015, the Company had negative working capital of (\$5,476,000) compared with negative working capital of (\$7,296,000) at the end of 2014.

During the years ended December 31, 2015 and 2014, the Company raised \$1,108,000 and \$2,181,000, respectively, of new working capital from the following:

Description	2015	2014
Issuance of convertible promissory notes	\$ 631,000	\$ 996,000
Sales of common stock under equity line of credit	407,000	162,000
Issuances of promissory notes to related parties	70,000	-
Sales of shares of common stock and warrants to the son of a director	-	515,000
Deposit on non-exclusive distribution license with China-based company	-	498,000
Proceeds from exercise of common stock warrants	-	10,000
	<u>\$ 1,108,000</u>	<u>\$ 2,181,000</u>

The Company continues to actively seek out new sources of working capital; however, there can be no assurance that it will be successful in these efforts. The accompanying financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

Certain amounts included in the accompanying financial statements for the year ended December 31, 2014 have been reclassified in order to make them comparable to the amounts presented for the year ended December 31, 2015.

#### *Majority-Owned Subsidiary*

CIL is currently the majority shareholder of Coates Hi-Tech Engines, Ltd., a Delaware corporation which was formed in July 2012. It has not commenced operations and has no assets.

#### *Revenue Recognition*

Sales and cost of sales are recognized at the time of shipment, provided the risk of loss has transferred to the customer and collection of the sales price is reasonably assured. Shipping arrangements and costs are the responsibility of the customer.

Revenue from research and development activities is recognized when collection of the related revenues is reasonably assured and, when applicable, in accordance with Accounting Standards Update No. 2010-17, "Milestone Method of Revenue Recognition, a consensus of the FASB Emerging Issues Task Force". This standard provides guidance on defining a milestone and permits recognition of revenue from research and development that is contingent upon achievement of one or more specified milestones defined in the research and development arrangements which meet specified criteria for such revenue recognition.

Deposits represent cash deposits received with orders to purchase Gen Sets.

License deposits, which are non-refundable, were received from the granting of sublicenses and are recognized as earned, generally commencing upon acceptance by the licensee. At that time, license revenue will be recognized ratably over the period of time that the sublicense has been granted using the straight-line method. Upon termination of a sublicense agreement, non-refundable license deposits, less any costs related to the termination of the sublicense agreement, are recognized as revenue. Revenue from research and development activities is recognized when earned and realization is reasonably assured, provided that financial risk has been transferred from the Company to its customer.

The Company is recognizing the license deposit of \$300,000 on the Canadian License as revenue on a straight-line basis over the approximate remaining life through 2027 of the last CSR<sup>V</sup>® technology patent in force.

#### *Research and Development*

Research and development costs are expensed when incurred. Included in accounts payable and accrued liabilities at December 31, 2015 and 2014 is \$115,000 for the estimated remediation costs of previously sold Gen Sets that were determined to have cracked heads.

#### *Intellectual Property*

Under a licensing agreement with George J. Coates and Gregory G. Coates, the Company obtained the rights to manufacture, use and sell the CSR<sup>V</sup>® engine technology throughout the territory defined as the Western Hemisphere. In accordance with GAAP, the Company is not permitted to record a value for this intellectual property because it was obtained from principal stockholders, and, accordingly this intangible asset is not reflected in the accompanying financial statements.

#### *Licensing Costs*

Under the CSRV<sup>®</sup> Licensing Agreement for the CSRV<sup>®</sup> engine technology, the Company is responsible for all costs in connection with applying for and maintaining patents to protect the CSRV<sup>®</sup> system technology. Such costs are expensed as incurred.

#### *Advertising and Marketing Costs*

Advertising costs, which are included in marketing expenses, are expensed when incurred. Advertising expense amounted to \$7,000 and \$48,000 for the years ended December 31, 2015 and 2014, respectively. In the year ended December 31, 2014, advertising and marketing costs included \$45,000 in fees to agents in China and the Middle East for their assistance in introducing our CSRV technology and presenting proposals to potential investors interested in entering into a sublicense arrangement with the Company.

#### *Stock-Based Compensation*

Stock-based compensation expense, which does not require any outlay of cash, consists of the following:

- The estimated fair value of shares of the Company's capital stock issued to key employees for anti-dilution protection pursuant to a resolution of the board of directors. This includes restricted shares of Series A Preferred Stock and Series B Convertible Stock. In 2014, the Company arranged for an independent professional services firm to determine the estimated fair value of Series A Preferred Stock issued in August 2014 and Series B Preferred Stock issued in July 2014. The approach to arriving at the estimated fair value of the Series B Convertible Preferred Stock was determined to have a close correlation to the trading price of the Company's common stock. Accordingly, upon each subsequent issuance of shares of Series B Convertible Preferred Stock, the original estimated fair value determined by the independent valuation is adjusted, on a pro rata basis, to reflect the closing price of the Company's common stock on each date of issuance.
- Compensation expense relating to stock options and stock awards under its stock option and incentive plans is recognized as an expense using the fair value measurement method. Under the fair value method, the estimated fair value of awards to employees is charged to income on a straight-line basis over the requisite service period, which is the earlier of the employee's retirement eligibility date or the vesting period of the award.

#### *Deferred Compensation*

Deferred compensation represents salaries of George J. Coates and Bernadette Coates earned but not paid in order to preserve the Company's working capital. The Company intends to repay these amounts at such time that it has sufficient working capital and after the related party notes to George J. Coates and Bernadette Coates have been repaid with interest thereon.

#### *Inventory*

Inventory consists of raw materials and work-in-process, including overhead and is stated at the lower of cost or market determined by the first-in, first-out method. Inventory items designated as obsolete or slow moving are reduced to net realizable value. Market value is determined using current replacement cost.

#### *Property, Plant and Equipment*

Property, plant and equipment is stated at cost. Depreciation is computed using the straight-line method over the estimated useful life of the assets: 40 years for buildings and building improvements, 3 to 7 years for machinery and equipment and 5 to 10 years for furniture and fixtures. Repairs and maintenance expenditures, which do not extend the useful lives of the related assets, are expensed as incurred.

In the event that facts and circumstances indicate that long-lived assets may be impaired, an evaluation of recoverability is performed. Should such evaluation indicate that there has been an impairment of one or more long-lived assets, the cost basis of such assets would be adjusted accordingly, at that time.

#### *Income Taxes*

Deferred income tax assets and liabilities are computed for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future. Such deferred income tax asset and liability computations are based on enacted tax laws and rates applicable to periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized and are adjusted when conditions indicate that deferred assets will be realized. Income tax expense (benefit) is the tax payable or refundable for the period, plus or minus the change during the period in deferred tax assets and liabilities.

The Company evaluates any uncertain tax positions for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes. In the event recognition of an uncertain tax position is indicated, the Company measures the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. This process of evaluating and estimating uncertain tax positions and tax benefits requires the consideration of many factors, which may require periodic adjustments and which may not accurately forecast actual outcomes. Interest and penalties, if any, related to tax contingencies would be included in income tax expense.

#### *Loss per Share*

Basic net loss per share is based on the weighted average number of common shares outstanding without consideration of potentially dilutive shares of common stock. There were no shares of preferred stock outstanding with rights to share in the Company's net income during the years ended December 31, 2015 and 2014. Diluted net income per share is based on the weighted average number of common and potentially dilutive common shares outstanding, when applicable.

#### *Use of Estimates*

The preparation of the Company's financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These significant estimates include determining the fair value of convertible promissory notes containing embedded derivatives and variable conversion rates, determining a value for shares of Series A Preferred Stock and Series B Convertible Stock issued and certain limited anti-dilution rights granted to George J. Coates as more fully described in Note 16, assigning useful lives to the Company's property, plant and equipment, determining an appropriate amount to reserve for obsolete and slow moving inventory, estimating a valuation allowance for deferred tax assets, assigning expected lives to, and estimating the rate of forfeitures of, stock options granted and selecting a trading price volatility factor for the Company's common stock in order to estimate the fair value of the Company's stock options on the date of grant or other appropriate measurement date. Actual results could differ from those estimates.

## **2. CONCENTRATIONS OF CREDIT AND BUSINESS RISK**

The Company maintains cash balances with two financial institutions. Monies on deposit with one of the institutions is currently fully insured by the Federal Deposit Insurance Corporation. Monies on deposit at the other financial institution amounting to \$3,000 are invested in a fund that invests in securities with maturities of 60 days or less.

The Company's operations are devoted to the development, application and marketing of the CSRV<sup>®</sup> system technology which was invented by George J. Coates, the Company's founder, Chairman, Chief Executive Officer, President and controlling stockholder. Development efforts have been conducted continuously during this time. From July 1982 through May 1993, seven U.S. patents as well as a number of foreign patents were issued with respect to the CSRV<sup>®</sup> system technology. Since inception of the Company in 1988, all aspects of the business have been completely dependent upon the activities of George J. Coates. The loss of George J. Coates' availability or service due to death, incapacity or otherwise would have a material adverse effect on the Company's business and operations. The Company does not presently have any key-man life insurance in force for Mr. Coates.

### 3. FAIR VALUE OF FINANCIAL INSTRUMENTS

#### *Cash, Other Assets, Accounts Payable and Accrued Liabilities and Other Liabilities*

With the exception of convertible promissory notes, the carrying amount of these items approximates their fair value because of the short term maturity of these instruments. The convertible promissory notes are reported at their estimated fair value, determined as described in more detail in Note 15.

#### *Limitations*

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

### 4. LICENSING AGREEMENT AND DEFERRED LICENSING COSTS

The Company holds a manufacturing, use, lease and sale license from George J. Coates and Gregory G. Coates for the CSRV<sup>®</sup> system technology in the territory defined as the Western Hemisphere (the "License Agreement"). Under the License Agreement, George J. Coates and Gregory G. Coates granted to the Company an exclusive, perpetual, royalty-free, fully paid-up license to the intellectual property that specifically relates to an internal combustion engine that incorporates the CSRV<sup>®</sup> system technology (the "CSRV<sup>®</sup> Engine") and that is currently owned or controlled by them (the "CSRV<sup>®</sup> Intellectual Property"), plus any CSRV<sup>®</sup> Intellectual Property that is developed by them during their employment with the Company. In the event of insolvency or bankruptcy of the Company, the licensed rights would terminate and ownership would revert back to George J. Coates and Gregory G. Coates.

Under the License Agreement, George J. Coates and Gregory G. Coates agreed that they will not grant any Western Hemisphere licenses to any other party with respect to the CSRV<sup>®</sup> Intellectual Property.

At December 31, 2015 and 2014 deferred licensing costs, comprised of expenditures for patent costs incurred pursuant to the CSRV<sup>®</sup> licensing agreement, net of accumulated amortization, amounted to \$42,000 and \$47,000, respectively. Amortization expense for the years ended December 31, 2015 and 2014 amounted to \$4,000 and \$4,000, respectively.

### 5. AGREEMENTS ASSIGNED TO ALMONT ENERGY, INC.

Almont Energy Inc. ("Almont"), a privately held, independent third-party entity based in Alberta, Canada is the assignee of a sublicense which provides for a \$5,000,000 license fee to be paid to the Company and covers the use of the CSRV<sup>®</sup> system technology in the territory of Canada in the oil and gas industry (the "Canadian License"). Almont is also the assignee of a separate research and development agreement ("R&D Agreement") which requires that Almont pay the remaining balance of an additional \$5,000,000 fee to the Company in consideration for the development and delivery of certain prototype engines. The Company completed development of the prototypes in accordance with this agreement at the end of 2007. The R&D Agreement has not been reduced to the form of a signed, written agreement.

Almont is also the assignee of an escrow agreement (the "Escrow Agreement") that provides conditional rights to a second sublicense agreement from the Company for the territory of the United States (the "US License"). The US License has been deposited into an escrow account and the grant of the license will not become effective until the conditions for release from escrow are satisfied. The US License provides for a license fee of \$50 million.

The Escrow Agreement requires that Almont, as the assignee, make a payment ("Release Payment") to the Company equal to the then remaining unpaid balance of the Canadian License licensing fee, the R&D Agreement fee and the down payment of \$1,000,000 required under the US License. It is not likely that Almont will be able to make additional payments of the Release Payment until the Company can raise sufficient new working capital to commence production and ship Gen Sets to Almont. At December 31, 2015, the remaining balance of the Release Payment due to the Company was \$5,847,000.

## 6. NON-EXCLUSIVE DISTRIBUTION SUBLICENSE WITH RENOWN POWER DEVELOPMENT, LTD.

In February 2015, the Company granted a non-exclusive distribution sublicense to Renown Power Development, Ltd., a China-based sales and distribution company (“Renown”) covering the territory defined as the Western Hemisphere. Under this sublicense, Renown will be permitted to sell, lease and distribute CSRV® products. This sublicense provides for payment of licensing fees to the Company amounting to US\$100 million. The Company received an initial non-refundable deposit of US\$500,000 to date. In addition, after Renown receives aggregate cash flow of US\$10,000,000, it is required to pay the Company 25% of all funds it receives from any and all sources until the entire US\$100 million licensing fee is paid in full. In the event that Renown completes one or more capital raises aggregating US\$300 million or more, the remaining unpaid balance of the US\$100 million licensing fee shall become immediately due and payable.

As collateral for payment of the sublicensing fee, Coates Power, Ltd. an independent China-based manufacturing company that will produce CSRV® products in China (“Coates Power”) and Renown are to place shares of their capital stock representing a 25% ownership interest into an escrow account for the benefit of the Company. These shares of stock will be released from escrow and revert back to Coates Power and Renown only after the US\$100 million sublicensing fee is paid in full. The Company does not have an ownership interest in Coates Power or Renown. Coates Power and Renown are controlled and managed by Mr. James Pang, the Company’s liaison agent in China.

Coates Power has agreed to initially source its production parts and components from the Company. In February 2015, the Company received an order from Coates Power for approximately US\$131,000 of production parts and components, at cost, in connection with its plans to manufacture two initial Gen Sets. In June, 2015, by mutual consent of the parties, it was agreed that the Company would assemble two completed Gen Sets for shipment to Coates Power in China in lieu of shipping the parts and components. This amount is included in Deposits in the accompanying balance sheet at December 31, 2015.

## 7. INVENTORY

Inventory at December 31, consisted of the following:

	2015	2014
Raw materials	\$ 554,000	\$ 381,000
Work-in-process	51,000	53,000
Finished goods	-	-
Less: Reserve for obsolescence	(387,000)	(387,000)
Total	<u>\$ 218,000</u>	<u>\$ 47,000</u>

## 8. LICENSE DEPOSITS

License deposits consist of monies received as deposits on sublicense agreements, primarily comprised of deposits from Renown in the amount of \$498,000 and from Almont in the amount of \$300,000. These deposits are to be recognized as income on a straight-line basis over the remaining period until expiration of the last remaining CSRV® patent in force in 2027. Through December 31, 2015, the Company has recognized a total of \$91,000 of the Almont deposit as revenue. The Company expects that sublicense-related activities by Renown may commence within the next twelve months and that it will begin recognizing revenue at that time. Recognition of revenue from the Almont license is included in the statements of operations for the years ended December 31, 2015 and 2014. The current portion of the license deposits represents the portion of the license deposits expected to be recognized as revenue within one year from the balance sheet date. The balance of the license deposits is included in non-current license deposits.

Sublicensing fee revenue for the years ended December 31, 2015 and 2014 amounted to \$94,000 and \$19,000, respectively. Included in sublicensing fee revenue for the year ended December 31, 2015 is \$75,000 non-refundable sublicense fee deposit received in 2002 that was abandoned by the licensee.

## 9. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at cost, less accumulated depreciation, consists of the following at December 31:

	2015	2014
Land	\$ 1,235,000	\$ 1,235,000
Building	964,000	964,000
Building improvements	83,000	83,000
Machinery and equipment	689,000	658,000
Furniture and fixtures	46,000	39,000
	<u>3,017,000</u>	<u>2,979,000</u>
Less: Accumulated depreciation	(908,000)	(860,000)
Total	<u>\$ 2,109,000</u>	<u>\$ 2,119,000</u>

Depreciation expense amounted to \$48,000 and \$61,000 for the years ended December 31, 2015 and 2014, respectively.

## 10. MORTGAGE LOAN PAYABLE

The Company has a mortgage loan on the land and building that serves as its headquarters and research and development facility which bears interest at the rate of 7.5% per annum and which, after securing a three year extension from the lender in July 2015, matures in July 2018. Interest expense for the year ended December 31, 2015 and 2014 on this mortgage amounted to \$100,000 and \$121,000, respectively. The loan requires monthly payments of interest, plus \$5,000 which is being applied to the principal balance. The remaining principal balance at December 31, 2015 and 2014 was \$1,388,000 and 1,448,000, respectively. The mortgage loan may be prepaid in whole, or, in part, at any time without penalty.

The loan is collateralized by a security interest in all of the Company's assets, the pledge of five million shares of common stock of the Company owned by George J. Coates, which were deposited into escrow for the benefit of the lender and the personal guarantee of George J. Coates. The Company is not permitted to create or permit any secondary mortgage or similar liens on the property or improvements thereon without prior consent of the lender.

## 11. FINANCE LEASE OBLIGATION

In August 2013, the Company entered into a sale/leaseback financing arrangement with Paradigm Commercial Capital Group Corp ("Paradigm") pursuant to which it sold its research and development and manufacturing equipment in consideration for net cash proceeds of \$133,000. These cash proceeds were net of a deposit on the lease of \$15,000 and transaction costs of \$5,000. Under this arrangement, which terminates in February 2016, the Company is leasing back the equipment over a 30-month period. The fixed recurring monthly lease payment amount is \$8,000. The effective interest rate on this lease is 36.6%.

In accordance with GAAP, this sale/leaseback is required to be accounted for as a financing lease. Under this accounting method, the equipment and accumulated depreciation remains on the Company's books and records as if the Company still owned the equipment. This accounting treatment is in accordance with ASC 840-40-25-4, Accounting for Sale-Leaseback Transactions. In addition, the discounted present value of the lease payments is recorded as a lease finance obligation. The difference between the gross sales price for the equipment and the net proceeds received amounted to \$20,000, which has been recorded as unamortized discount on finance lease obligation. This amount is being amortized to interest expense using the interest method over the term of the lease. The finance lease obligation is secured by all of the equipment included in the sale/leaseback transaction and the personal guaranty of George J. Coates.

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Notes to Financial Statements - (Continued)

For the years ended December 31, 2015 and 2014, interest expense on this lease amounted to \$32,000 and \$51,000, respectively, which is included in interest expense in the accompanying statements of operations.

## 12. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at December 31, are as follows:

	2015	2014
Legal and professional fees	\$ 1,368,000	\$ 1,290,000
Accrued interest expense	376,000	374,000
General and administrative expenses	163,000	194,000
Research and development costs	115,000	115,000
Accrued compensation and benefits	-	10,000
Total	<u>\$ 2,022,000</u>	<u>\$ 1,983,000</u>

## 13. PROMISSORY NOTES TO RELATED PARTIES

### *Promissory Notes Issued to George J. Coates*

During the year ended December 31, 2015, the Company issued, in a series of transactions, promissory notes to George J. Coates and received cash proceeds of \$70,000. During the years ended December 31, 2015 and 2014 the Company repaid promissory notes to George J. Coates in the aggregate principal amount of \$120,000 and \$145,000, respectively, and also paid him \$63,000 of accrued interest thereon in 2015. The promissory notes are payable on demand and provide for interest at the rate of 17% per annum, compounded monthly.

On April 29, 2014, Mr. Coates and the Company agreed to issue 39,682,540 shares of its common stock valued at \$950,000 to compensate Mr. Coates for the lost benefits of ownership of property that serves as the Company's headquarters, research and development and warehouse facility. He originally contributed the property to the Company in 1994 and did not receive any compensation therefore. The shares were valued at the closing price of \$0.0252 per share on April 29, 2014.

In addition, during May 2014, by mutual consent between Mr. Coates and the Company, the remaining \$370,000 principal amount of the promissory notes due to Mr. Coates was converted into restricted shares of common stock of the Company at the closing price per share of \$0.029 on May 30, 2014. These promissory notes arose from cash lent to the Company for working capital purposes from Mr. Coates' personal funds. Accordingly, the Company issued 12,749,162 shares of restricted common stock to Mr. Coates. In September 2014, by mutual consent between Mr. Coates and the Company, \$200,000 of the transaction converting promissory notes to common stock was rescinded. Accordingly, 6,896,552 shares of common stock were returned, cancelled and restored to authorized, unissued status and \$200,000 of promissory notes due to Mr. Coates was reinstated as a liability. The net result of this transaction and the partial rescission of this transaction was to reduce current liabilities by \$170,000 and reduce stockholders' deficiency by the same amount.

### *Promissory Note Issued to Gregory G. Coates*

During the period from August 21, 1995 to February 14, 1996, Gregory G. Coates, son of George J. Coates, President, Technology Division and Director, in a series of payments, made cash outlays from his own personal funds on behalf of the Company in an amount which aggregated \$1,462,000 to provide needed working capital to the Company in order for it to continue its operations. Gregory G. Coates contributed these funds to the Company and did not receive any consideration for this contribution. At that time, the \$1,462,000 of cash outlays was added to the Company's additional paid-in capital. Gregory G. Coates has been anticipating that these monies would be repaid to him at such time that the Company had sufficient working capital for this purpose. Gregory G. Coates has requested that this amount of additional paid-in capital be converted into a non-interest bearing promissory note. On April 28, 2014, the board of directors adopted a resolution to convert \$1,462,000 of additional paid-in capital of the Company into a non-interest bearing promissory note payable on demand, due to Gregory G. Coates. As a result, the Company's additional paid-in capital decreased by \$1,462,000 and current liabilities increased by \$1,462,000. As required by GAAP, interest at the rate of 10% per annum amounting to \$145,000 has been imputed on this promissory note for the year ended December 31, 2015.



During the year ended December 31, 2015, the Company partially repaid this promissory note to Gregory G. Coates in the aggregate principal amount of \$24,000.

*Promissory Notes Issued to Bernadette Coates*

During the years ended December 31, 2015 and 2014, the Company partially repaid promissory notes to Bernadette Coates, spouse of George J. Coates, in the aggregate principal amount of \$36,000 and \$55,000, respectively. The promissory notes are payable on demand and provided for interest at the rate of 17% per annum, compounded monthly.

*10% Promissory Note Due to Michael J. Suchar*

In June 2014, a 10% promissory note with a balance of \$17,000, due to Michael J. Suchar, director was converted, by mutual consent, into 612,664 restricted shares of common stock at a price per share of \$0.0285, the closing price of Company's common stock on the date of conversion.

For the years ended December 31, 2015 and 2014, aggregate interest expense on all promissory notes to related parties amounted to \$72,000 and \$92,000, respectively. Unpaid accrued interest on these promissory notes amounting to \$351,000 is included in accounts payable and accrued liabilities in the accompanying balance sheet at December 31, 2015.

**15. CONVERTIBLE PROMISSORY NOTES AND EMBEDDED DERIVATIVE LIABILITY**

From time to time, the Company issues convertible promissory notes. At December 31, 2015, there was \$558,000 principal amount of convertible promissory notes outstanding. The net proceeds from these convertible notes were used for general working capital purposes. During the years ended December 31, 2015 and 2014, \$659,000 and \$996,000, respectively, of convertible promissory notes were issued. The notes may be converted into unregistered shares of the Company's common stock at a discount ranging from 30% to 40% of the defined trading price of the common stock on the date of conversion. The defined trading prices are based on the trading price of the stock during a defined period ranging from ten to twenty-five trading days immediately preceding the date of conversion. The conversion rate discount establishes a beneficial conversion feature ("BCF") or unamortized discount, which is required to be valued and accreted to interest expense over the six-month period until the conversion of the notes into restricted shares of common stock is permitted. In addition, the conversion formula meets the conditions that require accounting for convertible notes as derivative liability instruments.

All of the convertible notes become convertible, in whole, or in part, beginning on the six month anniversary of the issuance date and may be prepaid at the option of the Company, generally with a prepayment penalty of from 25% to 50% of the principal amount of the convertible note at any time prior to becoming eligible for conversion.

One convertible promissory note with a balance of \$264,000, which became convertible in February 2016, is convertible in 12 equal monthly installments, plus accrued interest. The Company may elect, at its option to repay each monthly installment in whole, or in part, in cash without penalty. The amount of each installment not paid in cash is converted into shares of the Company's common stock. This convertible note also requires that the conversion price be re-measured 23 trading days after the conversion shares are originally delivered. If the re-measured conversion price is lower, then the Company is required to issue additional conversion shares to the noteholder.

In accordance with GAAP, the estimated fair value of the embedded derivative liability related to the convertible notes is required to be remeasured at each balance sheet date. The fair value measurement accounting standard establishes a valuation hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs market participants would use in valuing the asset or liability developed based on independent market data sources. Unobservable inputs are inputs that reflect the Company's assumptions about the factors market participants would use in valuing the asset or liability developed based upon the best information available. The valuation hierarchy is composed of three categories. The three levels of the fair value hierarchy are as follows:

- Level 1 – Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.

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- Level 2 – Inputs include quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly.
- Level 3 – Inputs to the fair value measurement are unobservable inputs or valuation techniques.

The estimated fair value of the embedded derivative liabilities related to promissory notes outstanding was measured as the aggregate estimated fair value, based on Level 2 inputs, which included the average of the quoted daily yield curve rates on six-month and one-year treasury securities and, because the actual volatility rate on the Company's common stock is not available, a conservative estimated volatility rate of 200%.

The embedded derivative liability arises because, based on historical trading patterns of the Company's stock, the formula for determining the Conversion Rate is expected to result in a different Conversion Rate than the closing price of the stock on the actual date of conversion (hereinafter referred to as the "Variable Conversion Rate Differential"). The estimated fair values of the derivative liabilities have been calculated based on a Black-Scholes option pricing model.

The following table presents the Company's fair value hierarchy of financial assets and liabilities measured at fair value on:

	December 31, 2015	December 31, 2014
Level 1 Inputs	\$ -	\$ -
Level 2 Inputs	633,000	871,000
Level 3 Inputs	-	-
Total	\$ 633,000	\$ 871,000

The following table presents the details of the convertible promissory notes outstanding at December 31, 2015 and 2014, including the balance of the unamortized discount and the amount of the embedded derivative liability, where applicable:

Date Issued	Principal Amount		Nominal Interest Rate	Effective Interest Rate <sup>(1)</sup>	Conversion Price Discount from Defined Trading Price	Unamortized Discount		Embedded Derivative Liability	
	December 31, 2015	December 31, 2014				December 31, 2015	December 31, 2014	December 31, 2015	December 31, 2014
12/8/15	\$ 40,000	\$ -	8.00%	88%	35.0%	\$ 20,000	N/A	\$ 50,000	N/A
11/10/15	25,000	-	12.00%	160%	40.0%	22,000	N/A	38,000	N/A
11/3/15	53,000	-	9.75%	183%	30.0%	17,000	N/A	64,000	N/A
9/22/15	67,000	-	8.00%	143%	39.0%	34,000	N/A	78,000	N/A
9/11/15	52,000	-	7.00%	65%	30.0%	8,000	N/A	28,000	N/A
8/26/15	20,000	-	12.00%	162%	40.0%	10,000	N/A	25,000	N/A
8/14/15	211,000	-	9.75%	84%	30.0%	29,000	N/A	259,000	N/A
7/24/15	63,000	-	8.00%	147%	39.0%	10,000	N/A	65,000	N/A
6/18/15	27,000	-	8.00%	112%	39.0%	-	N/A	26,000	N/A
12/16/14	-	\$ 28,000	12.00%	55%	40.0%	-	\$ 8,000	-	\$ 31,000
12/5/14	-	53,000	8.00%	160%	39.0%	-	42,000	-	20,000
11/25/14	-	52,000	9.75%	91%	30.0%	-	24,000	-	41,000
11/14/14	-	40,000	8.00%	139%	32.5%	-	30,000	-	54,000
10/2/14	-	40,000	8.00%	113%	35.0%	-	16,000	-	43,000
9/29/14	-	53,000	8.00%	118%	39.0%	-	29,000	-	20,000
9/3/14	-	39,000	12.00%	139%	40.0%	-	15,000	-	38,000
8/29/14	-	53,000	8.00%	105%	39.0%	-	13,000	-	17,000
8/8/14	-	52,000	9.75%	72%	30.0%	-	5,000	-	41,000
7/28/14	-	30,000	12.00%	156%	30.0%	-	6,000	-	25,000
7/9/14	-	83,000	8.00%	120%	39.0%	-	5,000	-	15,000
7/8/14	-	50,000	5.00%	106%	37.0%	-	2,000	-	31,000
6/12/14	-	47,000	8.00%	147%	40.0%	-	-	-	46,000
4/16/14	-	25,000	12.00%	147%	30.0%	-	-	-	17,000
4/16/14	-	24,000	12.00%	175%	40.0%	-	-	-	15,000
4/2/14	-	27,000	9.75%	71%	30.0%	-	-	-	22,000
	\$ 558,000	\$ 696,000				\$ 150,000	\$ 195,000	\$ 633,000	\$ 476,000

(1) The effective interest rate reflects the rate required to fully amortize the unamortized discount over the six-month period until the Notes become convertible.

In a series of transactions, during the year ended December 31, 2015, convertible promissory notes with an aggregate principal balance of \$974,000, including accrued interest thereon were converted into 520,777,116 unregistered shares of common stock. The Company incurred a loss on these conversions amounting to \$273,000 for the year ended December 31, 2015. In two transactions, during the year ended December 31, 2015, the Company also repaid \$54,000 of a convertible promissory note, including accrued interest thereon without penalty.

In a series of transactions, during the year ended December 31, 2014, convertible promissory notes with an aggregate principal balance of \$627,000, including accrued interest thereon were converted into 48,251,621 unregistered shares of common stock. The Company incurred a loss on these conversions amounting to \$95,000 for the year ended December 31, 2014.

At December 31, 2015, the Company had reserved 402,758,065 shares of its unissued common stock for conversion of convertible promissory notes.

The Company made the private placement of these securities in reliance upon Section 4(2) of the Securities Act of 1933, as amended (the "Act"), Rule 506 of Regulation D, and the rules and regulations promulgated thereunder, and/or upon any other exemption from the registration requirements of the Act, as applicable.

## 16. CAPITAL STOCK

### *Common Stock*

The Company's common stock is traded on OTC Pink Sheets. Investors can find real-time quotes and market information for the Company at [www.otcmarkets.com](http://www.otcmarkets.com) market system under the ticker symbol COTE. The Company is authorized to issue up to 2,000,000,000 shares of common stock, par value, \$0.0001 per share (the "Common Stock"). The Company intends to increase the number of authorized shares of common stock in the future on a timely basis, at any point that it is anticipated that issuances of common stock from sales of common stock or conversions of convertible instruments into common stock will warrant such an increase.

In March 2015, the majority stockholder authorized the board of directors to declare at some indefinite point in the future, a reverse stock split at such time as the board of directors determines, in its sole discretion, is appropriate based on market conditions and the Company's financial condition, results of operations and financial prospects. The Board may select a conversion ratio which shall be in the range of from (a) one new post-split share of common stock for 5 old pre-split shares of common stock (a 1:5 ratio) to (b) one new post-split share of common stock for 200 old pre-split shares of common stock (a 1:200 ratio). The Board is under no obligation to actually declare the reverse stock split and may never act on this authorization, unless it properly considers all conditions and factors and concludes that it is appropriate to do so. This authorization will continue in force until revoked by a corporate action consented to by the majority stockholder or by a vote of the stockholders.

The following common stock transactions occurred during the year ended December 31, 2015:

- In a series of transactions during the year ended December 31, 2015, convertible promissory notes with an aggregate principal balance of \$974,000, including accrued interest thereon were converted into 520,777,116 unregistered shares of common stock.
- In a series of transactions during the year ended December 31, 2015, the Company issued 72,505,910 registered shares of its common stock to Southridge Partners II LP (“Southridge”) under the 2014 and 2015 EP Agreements, as discussed in Note 22, in consideration for \$407,000. The proceeds were used for general working capital. The Company is required to deliver shares of its common stock to Southridge with each Put Notice based on the dollar amount of the Put Notice and the trading price of the common stock. At December 31, 2015, there were 15,000,000 shares of common stock held by Southridge which had not been sold. These shares may be held by Southridge until sold under a future Put Notice or until the Company requests that they be returned.

The following common stock transactions occurred during the year ended December 31, 2014:

- In a series of transactions, the Company made private sales, pursuant to stock purchase agreements of 16,456,076 unregistered shares of its common stock and 16,456,076 common stock warrants to purchase one restricted share of its common stock at exercise prices ranging from \$0.02 to \$0.04 per share in consideration for \$515,000 received from the son of Dr. Richard W. Evans, a director. The proceeds were used for general working capital.
- In a series of transactions, the Company issued 4,403,403 registered shares of common stock to Dutchess Opportunity Fund II, LP under an equity line of credit in consideration for \$162,000. The proceeds were used for general working capital.
- In two transactions during April and May, 17% promissory notes due to George J. Coates having a principal balance of \$420,000 were converted, by mutual consent, into 14,733,289 restricted shares of common stock at an average price per share of \$0.0285 which was equal to the closing price of the Company’s common stock on the dates of conversion. In August 2014, by mutual consent between the Company and George J. Coates, the conversion of \$200,000 of these 17% promissory notes was rescinded. Accordingly, 6,896,552 of the shares issued to Mr. Coates were returned for cancellation and restored to authorized, unissued status and the \$200,000 principal amount of the promissory note was reinstated.
- A non-interest bearing promissory note due to George J. Coates in the principal amount of \$950,000 was converted, by mutual consent, into 37,698,413 restricted shares of common stock at an average price per share of \$0.0252 which was equal to the closing price of the Company’s common stock on the date of conversion.
- A 10% promissory note with a balance of \$17,000 due to Michael J. Suchar, director, was converted, by mutual consent, into 612,664 restricted shares of common stock at an average price per share of \$0.0285 which was equal to the closing price of the Company’s common stock on the date of conversion.
- In a series of transactions, convertible promissory notes, including accrued interest thereon aggregating \$627,000 were converted into 48,251,621 unregistered shares of the Company’s common stock.
- The Company received proceeds of \$10,000 from the son of Richard W. Evans, a director for the exercise of stock purchase warrants with an exercise price of \$0.02 per share and issued 500,000 unregistered, restricted shares of its common stock. The proceeds were used for general working capital.

At December 31, 2015, the Company had reserved 450,572,976 shares of its common stock to cover the potential conversion of convertible securities and exercise of stock options and warrants.

*Preferred Stock and anti-dilution rights*

The Company is authorized to issue 100,000,000 shares of preferred stock, par value, \$0.001 per share (the "Preferred Stock"). The Company may issue any class of the Preferred Stock in any series. The board is authorized to establish and designate series, and to fix the number of shares included in each such series and the relative rights, preferences and limitations as between series, provided that, if the stated dividends and amounts payable on liquidation are not paid in full, the shares of all series of the same class shall share ratably in the payment of dividends including accumulations, if any, in accordance with the sums which would be payable on such shares if all dividends were declared and paid in full, and in any distribution of assets other than by way of dividends in accordance with the sums which would be payable on such distribution if all sums payable were discharged in full. Shares of each such series when issued shall be designated to distinguish the shares of each series from shares of all other series.

There are two series of Preferred Stock that have been designated to date from the total 100,000,000 authorized shares of Preferred Stock. These are as follows:

- Series A Preferred Stock, par value \$0.001 per share ("Series A"), 1,000,000 shares designated and 50,000 shares issued and outstanding as of December 31, 2015 and 2014. Shares of Series A entitle the holder to 10,000 votes per share on all matters brought before the shareholders for a vote. These shares are not entitled to receive dividends or share in distributions of capital and have no liquidation preference. All outstanding shares of Series A are owned by George J. Coates.

In order to enable the Company to raise needed working capital, an anti-dilution arrangement was established which authorized the issuance of shares of Series A to George J. Coates to restore the Coates Family's voting percentage upon any future issuance of new shares of the Company's common stock as a result of a sale or conversion of securities into common stock, provided, however, that no anti-dilution protection shall be available in connection with public offerings of the Company's securities.

During the period from January 1, 2014 to July 2, 2014, 40,191 shares of Series A were granted and issued to George J. Coates pursuant to this anti-dilution agreement. On July 3, 2014 all of the 181,664 shares of Series A previously issued to George J. Coates were converted into shares of Series B Convertible Preferred Stock, \$0.001 par value per share ("Series B"), as more fully explained below. All such converted shares of Series A were cancelled and restored to authorized, unissued status. At the same time, the aforementioned anti-dilution protection for Mr. Coates, pursuant to which shares of Series A may be issued, was cancelled and replaced with a new anti-dilution protection arrangement which involves the issuance of shares of Series B as more fully explained below. On August 1, 2014, 50,000 shares of Series A were issued to George J. Coates as an inducement to him to consider future offers from investors to acquire substantial ownership interests in the Company as a means of raising substantial new working capital for the Company. At December 31, 2015, Mr. Coates held all 50,000 shares of Series A outstanding, which entitle him to 500 million votes in addition to his voting rights from the shares of common stock and the shares of Series B he holds.

Each issuance of shares of Series A to George J. Coates did not have any effect on the share of dividends or liquidation value of the holders of the Company's common stock. However, the voting rights of the holders of the Company's common stock are diluted with each issuance.

In 2014, the Company arranged for an independent professional services firm to determine the estimated fair value of the shares of Series A provided to Mr. Coates. Based on this estimated valuation, the aggregate estimated fair value of the 50,000 shares of Series A issued to Mr. Coates on August 1, 2014, was \$69,000, or \$1.38 per share. Total non-cash, stock-based compensation expense from the grant of shares of Series A to Mr. Coates, including the shares converted to Series B for the years ended December 31, 2014, amounted to \$169,000. This amount is included in stock-based compensation expense in the accompanying statements of operations.

- Series B Convertible Preferred Stock, par value \$0.001 per share, 5,000,000 and 1,000,000 shares designated and 3,492,749 and 585,502 shares issued and outstanding as of December 31, 2015 and 2014, respectively. Shares of Series B do not earn any dividends and may be converted at the option of the holder at any time beginning on the second annual anniversary date after the date of issuance into 1,000 unregistered shares of the Company's common stock. Holders of the Series B are entitled to one thousand votes per share held on all matters brought before the shareholders for a vote.

In the event that either (i) the Company enters into an underwriting agreement for a secondary public offering of securities, or (ii) a change in control of the Company is consummated representing 50% more of the then outstanding shares of Company's common stock, plus the number of shares of common stock into which any convertible preferred stock is convertible, regardless of whether or not such shares are otherwise eligible for conversion, then the Series B may be immediately converted at the option of the holder into restricted shares of the Company's common stock.

On July 3, 2014, the board of directors consented to (i) the conversion of all of the 181,664 shares of Series A held by George J. Coates into shares of Series B at a conversion rate of one share of Series B for each share of Series A, (ii) an anti-dilution award of an additional 75,000 shares of Series B to Mr. Coates, and (iii) a modified anti-dilution plan, effective as of July 3, 2014 (the "Modified Plan") for George J. Coates.

The anti-dilution award of an additional 75,000 shares of Series B to Mr. Coates was determined to be the number of shares of Series B required to restore Mr. Coates' ownership percentage of outstanding common stock on a pro forma basis to 78%, assuming all of the Series B shares were converted into common stock. The ownership percentage of 78% represents the percentage of outstanding common stock that Mr. Coates originally held at December 31, 2002.

Under the Modified Plan, for each new share of common stock issued by the Company to non-Coates family members in the future, additional shares of Series B will be issued to Mr. Coates equal to that number of shares of Series B required to maintain his ownership percentage of outstanding shares of common stock on a pro forma basis, at 78%.

These anti-dilution provisions do not apply to new shares of common stock issued in connection with exercises of employee stock options, a secondary public offering of the Company's securities or a merger or acquisition.

In July 2014, the board of directors consented to an anti-dilution program which provides that shares of Series B be issued to Gregory G. Coates whenever new shares of common stock are issued to non-Coates family members in order to maintain his ownership percentage of common stock at 5.31% of the pro forma number of shares of common stock outstanding, assuming all shares of Series B were converted to common stock. This was his percentage ownership of common stock at December 31, 2002.

In July 2014, the board of directors consented to an anti-dilution program which provides that shares of Series B be issued to Barry C. Kaye whenever new shares of common stock are issued to non-Coates family members in order to maintain his ownership percentage of common stock at 0.04157% of the pro forma number of shares of common stock outstanding, assuming all shares of Series B were converted to common stock. This was the weighted average percentage ownership of common stock he purchased, based on the number of shares of common stock outstanding on each date he acquired additional shares of common stock.

The number of shares of Series B outstanding at December 31, 2015, consisted of 3,250,363, 224,975 and 17,411 shares held by George J. Coates, Gregory G. Coates and Barry C. Kaye, respectively. None of the outstanding shares of Series B may be converted prior to July 3, 2016.

For the year ended December 31, 2015, 2,708,430, 184,382 and 14,435 shares of Series B were issued to George J. Coates, Gregory G. Coates and Barry C. Kaye, respectively, having an estimated fair value of \$7,439,000, \$506,000 and \$40,000, respectively. These amounts were included in stock-based compensation expense in the accompanying statement of operations for the year ended December 31, 2015.

For the year ended December 31, 2014, 541,933, 40,593 and 2,976 shares of Series B were issued to George J. Coates, Gregory G. Coates and Barry C. Kaye, respectively, having an estimated fair value of \$8,070,000, \$607,000 and \$44,000, respectively. These amounts were included in stock-based compensation expense in the accompanying statement of operations for the year ended December 31, 2014.

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In the event that all of the 3,492,749 shares of Series B outstanding were converted, once the conversion restrictions lapse, an additional 3,492,749,000 new unregistered shares of common stock would be issued. On a pro forma basis, based on the number of shares of common stock outstanding at December 31, 2015, this would dilute the ownership percentage of non-affiliated stockholders from 72.3% to 16.2%.

To the extent that additional shares of Series B are issued under the anti-dilution plan, the non-affiliated stockholders' percentage ownership of the Company would be further diluted.

#### 18. SUBLICENSING FEE REVENUE

Sublicensing fee revenue for the years ended December 31, 2015 and 2014, amounted to \$94,000 and \$19,000, respectively. Included in sublicensing fee revenue for the year ended December 31, 2015 is a \$75,000 non-refundable sublicense fee deposit received in 2002 that was abandoned by the licensee. The Company is recognizing the license deposit of \$300,000 on the Canadian Licensee as revenue on a straight-line basis over the approximate remaining life until 2027 of the last CSRV<sup>®</sup> technology patent in force.

#### 19. INCOME (LOSS) PER SHARE

At December 31, 2015, the Company had 352,547,563 shares of common stock potentially issuable upon assumed conversion of:

Description	Number of Underlying Shares of Common Stock	Exercise Price	Number Vested	Number Non-Vested
Common stock options	703,000	\$ 0.02800	703,000	-
Common stock options	100,000	0.04200	100,000	-
Common stock options	5,607,000	0.06000	5,607,000	-
Common stock options	1,800,000	0.24000	1,800,000	-
Common stock options	2,000,000	0.25000	2,000,000	-
Common stock options	50,000	0.39000	50,000	-
Common stock options	360,000	0.40000	360,000	-
Common stock options	100,000	0.43000	100,000	-
Common stock options	1,750,000	0.44000	1,750,000	-
Common stock warrants	2,330,036	0.00500	N/A	N/A
Common stock warrants	1,250,000	0.02000	N/A	N/A
Common stock warrants	666,667	0.02250	N/A	N/A
Common stock warrants	2,127,660	0.02350	N/A	N/A
Common stock warrants	5,000,000	0.02500	N/A	N/A
Common stock warrants	1,739,130	0.02875	N/A	N/A
Common stock warrants	619,047	0.03000	N/A	N/A
Common stock warrants	2,714,287	0.03500	N/A	N/A
Common stock warrants	7,125,000	0.04000	N/A	N/A
Common stock warrants	333,333	0.04500	N/A	N/A
Common stock warrants	400,000	0.05000	N/A	N/A
Common stock warrants	2,181,819	0.05500	N/A	N/A
Common stock warrants	171,428	0.05700	N/A	N/A
Common stock warrants	285,714	0.05810	N/A	N/A
Common stock warrants	142,857	0.05850	N/A	N/A
Common stock warrants	2,000,000	0.06000	N/A	N/A
Common stock warrants	4,269,838	0.06250	N/A	N/A
Common stock warrants	333,333	0.06750	N/A	N/A
Common stock warrants	571,429	0.07000	N/A	N/A
Common stock warrants	666,666	0.09000	N/A	N/A
Common stock warrants	416,667	0.12000	N/A	N/A
Convertible promissory notes	304,732,652	(1)	N/A	N/A
Total	<u>352,547,563</u>			

- (1) The principal amount of convertible promissory notes outstanding at December 31, 2015 was \$558,000. Under the convertible terms of these notes, the number of shares of common stock into which these notes are convertible is variable because the conversion rates of the notes are based on the trading prices of the common stock over a defined number of trading days leading up to the conversion date during a defined conversion rate pricing period. The actual number of shares underlying these convertible instruments will likely vary from the number assumed above. The number of shares underlying these convertible notes was determined based on the defined conversion rates of the various convertible notes, assuming conversion had occurred as of December 31, 2015.

At December 31, 2014, the Company had 176,919,302 shares of common stock potentially issuable upon assumed conversion of convertible securities and exercise of stock options and warrants.

For the years ended December 31, 2015 and 2014, none of the potentially issuable shares of common stock were assumed to be converted because the Company incurred a net loss in those periods and the effect of including them in the calculation would have been anti-dilutive.

## 20. STOCK OPTIONS

The Company's 2006 Stock Option and Incentive Plan (the "Stock Plan") was adopted by the Company's board in October 2006. In September 2007, the Stock Plan, by consent of George J. Coates, majority shareholder, was adopted by our shareholders. The Stock Plan provides for the grant of stock-based awards to employees, officers and directors of, and consultants or advisors to, the Company and its subsidiaries, if any. Under the Stock Plan, the Company may grant options that are intended to qualify as incentive stock options within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended ("ISO's"), options not intended to qualify as incentive stock options ("non-statutory options"), restricted stock and other stock-based awards. ISO's may be granted only to employees of the Company. A total of 12,500,000 shares of common stock may be issued upon the exercise of options or other awards granted under the Stock Plan. The maximum number of shares with respect to which awards may be granted during any one year to any employee under the Stock Plan shall not exceed 25% of the 12,500,000 shares of common stock covered by the Stock Plan. All of the shares of common stock authorized under the Stock Plan have been granted and no further grants may be awarded thereunder.

The Company established a 2014 Stock Option and Incentive Plan (the "2014 Stock Plan") which was adopted by the Company's board on May 30, 2014. On March 2, 2015, the 2014 Stock Plan, by consent of George J. Coates, majority shareholder, was adopted by our shareholders. The 2014 Stock Plan provides for the grant of stock-based awards to employees, officers and directors of, and consultants or advisors to, the Company and its subsidiaries, if any. Under the 2014 Stock Plan, the Company may grant ISO's, non-statutory options, restricted stock and other stock-based awards. ISO's may be granted only to employees of the Company. A total of 50,000,000 shares of common stock may be issued upon the exercise of options or other awards granted under the 2014 Stock Plan. The maximum number of shares with respect to which awards may be granted during any one year to any employee under the 2014 Stock Plan shall not exceed 25% of the 50,000,000 shares of common stock covered by the 2014 Stock Plan. At December 31, 2015, none of the shares of common stock authorized under the 2014 Stock Plan had been granted as stock options or awarded.

The Stock Plan and the 2014 Stock Plan (the "Stock Plans") are administered by the board and the Compensation Committee. Subject to the provisions of the Stock Plans, the board and the Compensation Committee each has the authority to select the persons to whom awards are granted and determine the terms of each award, including the number of shares of common stock subject to the award. Payment of the exercise price of an award may be made in cash, in a "cashless exercise" through a broker, or if the applicable stock option agreement permits, shares of common stock, or by any other method approved by the board or Compensation Committee. Unless otherwise permitted by the Company, awards are not assignable or transferable except by will or the laws of descent and distribution.



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Upon the consummation of an acquisition of the business of the Company, by merger or otherwise, the board shall, as to outstanding awards (on the same basis or on different bases as the board shall specify), make appropriate provision for the continuation of such awards by the Company or the assumption of such awards by the surviving or acquiring entity and by substituting on an equitable basis for the shares then subject to such awards either (a) the consideration payable with respect to the outstanding shares of common stock in connection with the acquisition, (b) shares of stock of the surviving or acquiring corporation, or (c) such other securities or other consideration as the board deems appropriate, the fair market value of which (as determined by the board in its sole discretion) shall not materially differ from the fair market value of the shares of common stock subject to such awards immediately preceding the acquisition. In addition to, or in lieu of the foregoing, with respect to outstanding stock options, the board may, on the same basis or on different bases as the board shall specify, upon written notice to the affected optionees, provide that one or more options then outstanding must be exercised, in whole or in part, within a specified number of days of the date of such notice, at the end of which period such options shall terminate, or provide that one or more options then outstanding, in whole or in part, shall be terminated in exchange for a cash payment equal to the excess of the fair market value (as determined by the board in its sole discretion) for the shares subject to such stock options over the exercise price thereof. Unless otherwise determined by the board (on the same basis or on different bases as the board shall specify), any repurchase rights or other rights of the Company that relate to a stock option or other award shall continue to apply to consideration, including cash, that has been substituted, assumed or amended for a stock option or other award pursuant to these provisions. The Company may hold in escrow all or any portion of any such consideration in order to effectuate any continuing restrictions.

The board may at any time provide that any stock options shall become immediately exercisable in full or in part, that any restricted stock awards shall be free of some or all restrictions, or that any other stock-based awards may become exercisable in full or in part or free of some or all restrictions or conditions, or otherwise realizable in full or in part, as the case may be.

The board or Compensation Committee may, in its sole discretion, amend, modify or terminate any award granted or made under the Stock Plan, so long as such amendment, modification or termination would not materially and adversely affect the participant.

During the year ended December 31, 2014, options to purchase 703,000 shares of common stock at an exercise price of \$0.028 per share were granted. The stock options fully vested in April 2015. The estimated fair value of these stock options was \$20,000.

During the year ended December 31, 2015, stock options to purchase 703,000 shares of common stock at an exercise price of \$0.028 per share became vested. During the year ended December 31, 2014, stock options to purchase 100,000 shares of common stock at an exercise price of \$0.042 per share became vested. The estimated fair value of stock options which vested during the years ended December 31, 2015 and 2014 was \$20,000 and \$4,000, respectively.

There were no unvested stock options outstanding at December 31, 2015.

During the years ended December 31, 2015 and 2014, the Company recorded non-cash stock-based compensation expense related to employee stock options amounting to \$7,000 and \$17,000, respectively.

A summary of the activity in the Company's Stock Option Plan is as follows:

	Exercise Price Per Share	Number Outstanding	Weighted Average Remaining Contractual Life	Number Exercisable	Weighted Average Exercise Price	Weighted Average Fair Value Per Stock Option at Date of Grant
Balance, 1/1/14	\$0.042 – \$1.000	11,797,000	13	11,697,000	\$ 0.193	\$ 0.179
Stock options granted	0.028	703,000	15	-	0.028	0.028
Stock options vested	0.042	-	14	100,000	0.420	0.042
Balance, 12/31/14	0.028 – 1.000	12,500,000	12	11,797,000	0.184	0.169
Stock options vested	0.0028			703,000		
Stock options expired	1.000	(30,000)		(30,000)		
Balance, 12/31/15	\$0.028 – \$0.440	12,470,000	11	12,470,000	0.182	0.169

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The weighted average fair value of the Company's stock options was estimated using the Black-Scholes option pricing model which requires highly subjective assumptions including the expected stock price volatility. These assumptions were as follows:

• Historical stock price volatility	139% - 325%
• Risk-free interest rate	0.21% - 4.64%
• Expected life (in years)	4
• Dividend yield	0.00

The valuation assumptions were determined as follows:

- Historical stock price volatility: The Company utilized the volatility in the trading of its common stock computed for the 12 months of trading immediately preceding the date of grant.
- Risk-free interest rate: The Company bases the risk-free interest rate on the interest rate payable on U.S. Treasury securities in effect at the time of the grant for a period that is commensurate with the assumed expected option life.
- Expected life: The expected life of the options represents the period of time options are expected to be outstanding. The Company has very limited historical data on which to base this estimate. Accordingly, the Company estimated the expected life based on its assumption that the executives will be subject to frequent blackout periods during the time that the stock options will be exercisable and based on the Company's expectation that it will complete its research and development phase and commence its initial production phase. The vesting period of these options was also considered in the determination of the expected life of each stock option grant.
- No expected dividends.

The following table sets forth information with respect to stock options outstanding at December 31, 2015:

Name	Title	Number of Shares of Common Stock Underlying Stock Options <sup>(1)</sup>	Exercise Price per Share	Option Expiration Date
George J. Coates	Chairman, Chief Executive Officer and President	1,000,000	\$ 0.440	10/23/2021
		50,000	0.430	11/4/2024
		275,000	0.400	11/17/2025
		1,800,000	0.250	7/25/2026
		1,815,000	0.060	6/24/2027
Gregory G. Coates	Director and President, Technology Division	500,000	0.440	10/23/2021
		1,800,000	0.240	8/8/2026
		351,500	0.028	4/30/2029
Barry C. Kaye	Director, Treasurer and Chief Financial Officer	125,000	0.440	10/18/2021
		100,000	0.042	2/11/2028
		351,500	0.028	4/30/2029
Dr. Frank J. Adipietro	Non-employee Director	25,000	0.440	3/28/2022
		50,000	0.430	11/3/2024
		85,000	0.400	11/17/2025
		667,000	0.060	6/24/2027
Dr. Richard W. Evans	Consultant	25,000	0.440	3/28/2022
		50,000	0.390	12/27/2024
		200,000	0.250	2/15/2026
		3,125,000	0.060	6/20/2027
Dr. Michael J. Suchar	Consultant	25,000	0.440	3/28/2022
Richard Whitworth	Non-employee Director	25,000	0.440	3/28/2022
William Wolf, Esq.	Outside General Counsel	25,000	0.440	4/4/2022

<sup>(1)</sup> All outstanding stock options are fully vested.

## 21. EQUITY PURCHASE AND REGISTRATION RIGHTS AGREEMENTS

### *Southridge Partners II LP*

In July 2014, the Company entered into an equity purchase agreement (the “2014 EP Agreement”) with Southridge Partners II LP, a Delaware limited partnership (“Southridge”). Pursuant to the terms of the 2014 EP Agreement, Southridge committed to purchase up to 40,000,000 shares of the Company’s common stock, in exchange for consideration not to exceed Ten Million (\$10,000,000) Dollars. In June 2015, the 2014 Agreement automatically terminated because Southridge had purchased all 40,000,000 shares of common stock permitted under the 2014 EP Agreement. Accordingly, on July 29, 2015, the Company entered into a new 3-year equity purchase agreement (the “2015 EP Agreement”) with Southridge. Pursuant to the terms of the 2015 EP Agreement, Southridge committed to purchase up to 205,000,000 shares of the Company’s common stock, in exchange for consideration not to exceed Twenty Million (\$20,000,000) Dollars on the same terms and conditions as the 2014 EP Agreement.

The terms of the 2014 and 2015 EP Agreements provided that the purchase price for the shares of common stock shall be equal to 94% of the lowest closing price of the common stock during the ten trading days that comprise the defined pricing period. The Company is entitled to exercise a Put to Southridge by delivering a Put Notice, which requires Southridge to remit the dollar amount stated in the Put Notice at the end of the pricing period, provided, however, that for each day during the pricing period, if any, that the daily closing price of the Company’s common stock is (i) 25% or more below the Floor Price, as defined, or (ii) below the Floor Price, if any, stipulated in the Put Notice issued by the Company, then the dollar amount of the Put shall be reduced by 10% for each such day. The Company may stipulate a Floor Price below which, no shares of common stock may be sold by Southridge, however, the Floor price shall not be lower than the lowest daily volume weighted average price of the common stock during the ten trading days preceding the date of the Put Notice.

The Company also entered into a registration rights agreement (the “Registration Rights Agreement”) with Southridge. Pursuant to the terms of the Registration Rights Agreement, on July 30, 2015, the Company filed a registration statement with the SEC covering 205,000,000 shares of common stock underlying the 2015 EP Agreement which was declared effective August 5, 2015.

During the year ended December 31, 2015, the Company (i) sold all of the 40,000,000 registered shares of common stock to Southridge and received proceeds of \$207,000 under the 2014 EP Agreement, and (ii) sold 32,505,910 registered shares of common stock to Southridge and received proceeds of \$200,000 under the 2015 EP Agreement.

### *Dutchess Opportunity Fund II, LP*

Pursuant to the terms of an Investment Agreement with Dutchess Opportunity Fund II, LP, in a series of purchase transactions (“Puts”), 4,403,403 registered shares of the Company’s common stock were sold and the Company received proceeds of \$162,000, which were used for general working capital purposes. This agreement terminated in 2014. There were no offering costs related to the sales of these shares.

## 22. INCOME TAXES

Deferred income taxes are determined using the liability method for the temporary differences between the financial reporting basis and income tax basis of the Company’s assets and liabilities. Deferred income taxes are measured based on the tax rates expected to be in effect when the temporary differences are included in the Company’s tax return. Deferred tax assets and liabilities are recognized based on anticipated future tax consequences attributable to differences between financial statement carrying amounts of assets and liabilities and their respective tax bases.

Deferred tax assets increased by \$3,672,000 and \$3,178,000 for the years ended December 31, 2015 and 2014, respectively. These amounts were fully offset by a corresponding increase in the tax valuation allowance resulting in no net change in deferred tax assets, respectively, during these periods.

Coates International, Ltd.  
Notes to Financial Statements - (Continued)

No liability for unrecognized tax benefits was required to be reported at December 31, 2015 and 2014. Based on the Company's evaluation, it has concluded that there are no significant uncertain tax positions requiring recognition in the Company's financial statements. The Company's evaluation was performed for the tax years ended 2011 through 2014, the only periods subject to examination. The Company believes that its income tax positions and deductions will be sustained on audit and does not anticipate that adjustments, if any, will result in a material change to its financial position. For the years ended December 31, 2015 and 2014, there were no penalties or interest related to the Company's income tax returns.

Total deferred tax assets and valuation allowances are as follows at December 31:

	<u>2015</u>	<u>2014</u>
Current deferred tax asset - inventory reserve	\$ 195,000	\$ 195,000
<b>Non-Current Deferred Tax Assets:</b>		
Net operating loss carryforwards	7,213,000	6,475,000
Stock-based compensation expense	7,272,000	4,242,000
Accrued liabilities not paid	369,000	464,000
Deferred compensation not paid within 2.5 months	450,000	432,000
Accrued interest on notes to related parties	140,000	159,000
Total long-term deferred tax assets	<u>15,445,000</u>	<u>11,772,000</u>
Total deferred tax assets	15,639,000	11,967,000
Less: valuation allowance	<u>(15,639,000)</u>	<u>(11,967,000)</u>
Net deferred tax assets	<u>\$ -</u>	<u>\$ -</u>

The differences between income tax (benefit) provision in the financial statements and the income tax (benefit) provision computed at the U.S. Federal statutory rate of 34% at December 31 are as follows:

	<u>2015</u>	<u>2014</u>
Federal tax provision at the statutory rate	34.0%	34.0%
State income tax provision (benefit), net of federal benefit	(0.9)	(2.2)
Stock-based compensation expense	(29.7)	(20.0)
Deferred compensation not paid within 2.5 months	0.6	(2.5)
Accrued interest not deductible for tax return purposes	(3.4)	(2.5)
Net change in net operating loss carryforwards	(7.2)	(2.1)
Loss on conversion of convertible notes	(1.1)	0.0
Increase in estimated fair value of embedded derivative liabilities	(0.6)	(0.3)
Accrued liabilities not deductible for tax return purposes	(0.1)	0.3
Officer's life insurance	(0.0)	(0.0)
Total	<u>(8.4)</u>	<u>(4.7)</u>
Valuation allowance	8.4	4.7
Effective tax rate	<u>0.0%</u>	<u>0.0%</u>

At December 31, 2015, the Company had available, \$19,423,000 of net operating loss carryforwards which may be used to reduce future federal taxable income, expiring between 2018 and 2035. At December 31, 2015, the Company had available \$9,276,000 of net operating loss carryforwards which may be used to reduce future state taxable income, expiring between 2016 and 2035.

### 23. RELATED PARTY TRANSACTIONS

#### *Issuances of Common Stock and Warrants*

Issuances of common stock and common stock warrants to related parties during the year ended December 31, 2015 and 2014 are discussed in detail in Note 16.

Promissory notes to related parties converted into restricted shares of the Company's common stock are discussed in detail in Note 13.

*Issuances of Promissory Notes to Related Parties*

Issuances of promissory notes to related parties during the years ended December 31, 2015 and 2014 to related parties are discussed in detail in Note 13.

The promissory notes issued to George J. Coates and Bernadette Coates are payable on demand and provide for interest at the rate of 17% per annum, compounded monthly. The promissory note issued to Gregory G. Coates is non-interest bearing.

At December 31, 2015, interest accrued but not paid on outstanding promissory notes to related parties, aggregated \$344,000.

*Stock Options Granted*

Stock options granted to related parties during the years ended December 31, 2015 and 2014 are discussed in detail in Note 21.

*Issuances of Preferred Stock*

Shares of Series A Preferred Stock awarded to George J. Coates during the years ended December 31, 2014 are discussed in detail in Note 16.

Shares of Series B Convertible Preferred Stock awarded to George J. Coates, Gregory G. Coates and Barry C. Kaye during the years ended December 31, 2015 and 2014 are discussed in detail in Note 16.

*Personal Guaranty and Stock Pledge*

In connection with the Company's mortgage loan on the Company's headquarters facility, George J. Coates has pledged certain of his shares of common stock of the Company to the extent required by the lender and provided a personal guaranty as additional collateral.

In connection with the Company's sale/leaseback of its research and development and manufacturing equipment, George J. Coates provided his personal guaranty.

*Compensation and Benefits Paid*

The approximate amount of compensation and benefits, all of which were approved by the board, paid to George J. Coates, Gregory G. Coates and Bernadette Coates, exclusive of stock-based compensation for unregistered, restricted shares of Preferred Stock awarded to George J. Coates and Gregory G. Coates and non-cash, stock-based compensation for employee stock options granted to Gregory G. Coates is summarized as follows:

	For the Year Ended,	
	2015	2014
George J. Coates (a) (b) (c) (d) (e)	\$ 18,000	\$ 16,000
Gregory G. Coates (f) (g)	178,000	177,000
Bernadette Coates (h)	4,000	4,000

Coates International, Ltd.  
Notes to Financial Statements - (Continued)

- (a) For the years ended December 31, 2015 and 2014, George J. Coates earned additional base compensation of \$250,000 and \$250,000, respectively, payment of which is being deferred until the Company has sufficient working capital. This amount is included in deferred compensation in the accompanying balance sheets at December 31, 2015 and 2014.
- (b) During the year ended December 31, 2014, George J. Coates received a compensatory award of the Company's common stock valued at \$950,000 to compensate him for the lost benefits of ownership of the property he contributed to the Company as more fully discussed in Note 13.
- (c) During the period from January 1, 2014 to July 2, 2014, 40,191 shares of Series A Preferred Stock, having an estimated fair value of \$100,000 were granted and issued to George J. Coates pursuant to an anti-dilution agreement. On July 3, 2014 181,664 shares of Series A Preferred Stock comprising all of the shares of Series A Preferred Stock previously issued to George J. Coates were converted into 181,664 shares of Series B Convertible Preferred Stock, \$0.001 par value per share.
- (d) On August 1, 2014, 50,000 shares of Series A Preferred Stock with an estimated fair value of \$69,000, were issued to George J. Coates as an inducement to him to consider future offers from investors to acquire substantial ownership interests in the Company as a means of raising substantial new working capital for the Company.
- (e) During the year ended December 31, 2015 and 2014, George J. Coates was awarded 2,708,430 and 541,933 shares of Series B Convertible Preferred Stock, respectively, with an estimated fair value of \$7,495,000 and \$8,070,000, respectively, for anti-dilution. Each share of Series B Convertible Preferred Stock becomes convertible into 1,000 shares of common stock at any time after the second anniversary after the date of issuance.
- (f) Includes compensation paid in 2015 and 2014 for vacation earned but not taken.
- (g) During the years ended December 31, 2015 and 2014, Gregory G. Coates was awarded 184,382 and 40,593 shares of Series B Convertible Preferred Stock with an estimated fair value of \$506,000 and \$607,000, respectively, for anti-dilution. Each share of Series B Convertible Preferred Stock becomes convertible into 1,000 shares of common stock at any time after the second anniversary after the date of issuance.
- (h) For the years ended December 31, 2015 and 2014, Bernadette Coates earned additional base compensation of \$67,000 and \$67,000, respectively, payment of which is being deferred until the Company has sufficient working capital. These amounts are included in deferred compensation in the accompanying balance sheets at December 31, 2015 and 2014.

During the years ended December 31, 2015 and 2014, Barry C. Kaye, Treasurer and Chief Financial Officer was paid compensation of \$83,000 and \$170,000, respectively. For the year ended December 31, 2015, Mr. Kaye earned compensation of \$111,000, \$5,000 of which was paid and the unpaid balance of \$106,000 is being deferred until the Company has sufficient working capital to remit payment to him. This unpaid amount is included in accounts payable and accrued liabilities in the accompanying balance sheet at December 31, 2015. During the years ended December 31, 2015 and 2014, Barry C. Kaye was awarded 14,435 and 2,976 shares of Series B Convertible Preferred Stock, respectively, with an estimated fair value of \$40,000 and \$44,000, respectively, for anti-dilution. Each share of Series B Convertible Preferred Stock becomes convertible into 1,000 shares of common stock at any time after the second anniversary after the date of issuance.

#### 24. CONTRACTUAL OBLIGATIONS AND COMMITMENTS

The following table summarizes our contractual obligations and commitments at December 31, 2015:

	Total	Due Within		
		2016	2017	2018
Promissory notes to related parties	\$ 1,456,000	\$ 1,456,000	\$ -	\$ -
Mortgage loan payable	1,388,000	60,000	60,000	1,268,000
Deferred compensation	922,000	922,000	-	-
Convertible promissory notes	558,000	294,000	264,000	-
Finance lease obligation	23,000	23,000	-	-
Total	<u>\$ 4,347,000</u>	<u>\$ 2,755,000</u>	<u>\$ 324,000</u>	<u>\$ 1,268,000</u>

## 25. LITIGATION AND CONTINGENCIES

The Company is not a party to any litigation that is material to its business.

## 26. RECENTLY ISSUED ACCOUNTING STANDARDS

In November 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2015-17, "Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes". This update was designed to simplify the presentation of deferred taxes by eliminating the requirement to separately classify the current and non-current portion of deferred tax assets and liabilities. Accordingly, this update will require that all deferred tax assets and liabilities be presented as non-current. This update will become effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Earlier application is permitted as of the beginning of an interim or annual reporting period. The Company is currently evaluating the impact of this update and the transition alternatives, however, at this time it does not expect it will have a material effect on its financial statements.

In July 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2015-11, "Inventory – Simplifying the Measurement of Inventory (Topic 330)". This update requires that inventory value be measured at the lower of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. Currently, generally accepted accounting principles require that inventory be valued at the lower of cost or market price to replace the inventory. This update is to become effective for annual and interim financial statements for fiscal years ending after December 15, 2016. Earlier application is permitted. This update is required to be applied prospectively. The Company is currently evaluating the impact of this update; however, at this time it does not expect it will have a material effect on its financial statements.

In August 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-15, "Presentation of Financial Statements - Going Concern (Subtopic 205-40)", which was issued in order to provide guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related financial statement disclosures. It requires that management evaluate whether there are conditions or events, when considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date of both the annual and interim financial statements ("Going Concern Doubt"). The evaluation should be based on relevant conditions and events that are known and reasonably knowable at the date of the financial statements. When such evaluation determines that Going Concern Doubt does exist, then management is required to consider whether or not it is probable that its plans to mitigate the Going Concern Doubt can be effective and timely to address the Going Concern Doubt. This update further provides disclosure requirements in the notes to financial statements both when such doubt is probable of being mitigated and when such doubt is not probable of being mitigated by management's plans. This update is to become effective for annual and interim financial statements for fiscal years ending after December 15, 2016. As permitted thereunder, the Company has elected to implement this update early and it has been applied in the financial statements for the years ended December 31, 2015 and 2014. Early adoption did not have a material effect on the Company's financial position or results of operations.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers," (Topic 606): which amended the existing accounting standards for revenue recognition. The amendments are based on the principle that revenue should be recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. The Company will be required to adopt this accounting standard in the first quarter of fiscal 2018. Early adoption is not permitted. The amendments may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. The Company is currently evaluating the impact of these amendments and the transition alternatives, however, at this time it does not anticipate that it will have a material effect on its financial statements.

## 27. SUBSEQUENT EVENTS

### *Common Stock Sold Under Equity Purchase Agreement*

During the three months ended March 31, 2016, the Company sold 37,619,488 registered shares of its common stock in accordance with the 2015 Equity Purchase Agreement and received cash proceeds of \$100,000. In February 2016, the Company delivered a Put Notice to Southridge and delivered the requisite number of shares of its common stock as required under the Equity Purchase Agreement, 15,611,008 of which had not been sold as of April 8, 2016. These shares may be sold by Southridge at any time if there is a Put Notice in force or returned upon request of the Company.

### *Issuance of Convertible Promissory Notes*

During the three months ended March 31, 2016, the Company issued three convertible promissory notes and received net proceeds of \$88,000 after transaction costs. The holders may convert the convertible note at any time beginning six months after funding, into shares of the Company's common stock at a conversion price ranging from 62% to 70% of the trading price, as defined, of the Company's common stock over a specified trading period prior to the date of conversion.

### *Private Sales of Shares of Common Stock and Common Stock Warrants*

In March and April 2016, the Company issued 35,000,000 unregistered, restricted shares of common stock and 35,000,000 common stock warrants to purchase one share of restricted common stock at a price per share of \$0.001 to a private investor in consideration for \$35,000. This transaction was a private sale of unregistered, restricted securities.

### *Conversion of Convertible Promissory Notes*

During the three months ended March 31, 2016, in a series of transactions, \$300,000 principal amount of convertible promissory notes, including accrued interest thereon were converted into 239,858,385, unregistered shares of the Company's common stock.

### *Issuance of Anti-dilution shares*

During the three months ended March 31, 2016, the Company issued 1,263,978, 86,048 and 6,736 shares of Series B Convertible Preferred Stock to George J. Coates, Gregory G. Coates and Barry C. Kaye, respectively, representing anti-dilution shares related to newly issued shares of common stock. The estimated fair value of these shares was \$1,641,000, \$112,000 and \$9,000, respectively.

### *Issuance and Repayment of 17% Promissory Notes to Related Parties*

In April 2016, the Company issued a \$5,000, 17% promissory note due to George J. Coates. In February 2016, the Company partially repaid 17% promissory notes due to George J. Coates amounting \$10,000.

### *Deferred Compensation*

As of April 8, 2015, George J. Coates, Barry C. Kaye and Bernadette Coates agreed to additional deferral of their compensation amounting to \$64,000, \$29,000 and \$17,000, respectively, bringing their total deferred compensation to \$795,000, \$135,000 and \$209,000, respectively.

### *Designation of Series B Convertible Preferred Stock*

In February 2016, the Company designated an additional 20,000,000 shares of Preferred Stock as Series B Convertible Preferred Stock, par value \$0.001 per share, bringing the total number of authorized shares to 25,000,000.



**THIS NOTE AND THE COMMON STOCK ISSUABLE UPON CONVERSION OF THIS NOTE HAVE NOT BEEN AND WILL NOT BE REGISTERED WITH THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION OR THE SECURITIES COMMISSION OF ANY STATE PURSUANT TO AN EXEMPTION FROM REGISTRATION PROVIDED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND THE RULES AND REGULATIONS PROMULGATED THEREUNDER (THE "1933 ACT")**

US \$33,000.00

COATES INTERNATIONAL, LTD.  
10% CONVERTIBLE REDEEMABLE NOTE  
DUE FEBRUARY 12, 2017

FOR VALUE RECEIVED, Coates International, Ltd. (the "Company") promises to pay to the order of APG CAPITAL HOLDINGS, LLC and its authorized successors and Permitted Assigns, defined below, ("Holder"), the aggregate principal face amount of Thirty Three Thousand Dollars exactly (U.S. \$33,000.00) on February 12, 2017 ("Maturity Date") and to pay interest on the principal amount outstanding hereunder at the rate of 10% per annum commencing on February 12, 2016. The interest will be paid to the Holder in whose name this Note is registered on the records of the Company regarding registration and transfers of this Note. The principal of, and interest on, this Note are payable at 300 Cadman Plaza West, 12th Floor, Brooklyn, NY 11201, initially, and if changed, last appearing on the records of the Company as designated in writing by the Holder hereof from time to time. The Company will pay each interest payment and the outstanding principal due upon this Note before or on the Maturity Date, less any amounts required by law to be deducted or withheld, to the Holder of this Note by check or wire transfer addressed to such Holder at the last address appearing on the records of the Company. The forwarding of such check or wire transfer shall constitute a payment of outstanding principal hereunder and shall satisfy and discharge the liability for principal on this Note to the extent of the sum represented by such check or wire transfer. Interest shall be payable in Common Stock (as defined below) pursuant to paragraph 4(b) herein. Permitted Assigns means any Holder assignment, transfer or sale of all or a portion of this Note accompanied by an Opinion of Counsel as provided for in Section 2(f) of the Securities Purchase Agreement.

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This Note is subject to the following additional provisions:

1. This Note is exchangeable for an equal aggregate principal amount of Notes of different authorized denominations, as requested by the Holder surrendering the same. No service charge will be made for such registration or transfer or exchange, except that Holder shall pay any tax or other governmental charges payable in connection therewith. To the extent that Holder subsequently transfers, assigns, sells or exchanges any of the multiple lesser denomination notes, Holder acknowledges that it will provide the Company with Opinions of Counsel as provided for in Section 2(f) of the Securities Purchase Agreement.

2. The Company shall be entitled to withhold from all payments any amounts required to be withheld under applicable laws.

3. This Note may be transferred or exchanged only in compliance with the Securities Act of 1933, as amended ("Act"), applicable state securities laws and Sections 2(f) and 5(f) of the Securities Purchase Agreement. Any attempted transfer to a non-qualifying party shall be treated by the Company as void. Prior to due presentment for transfer of this Note, the Company and any agent of the Company may treat the person in whose name this Note is duly registered on the Company's records as the owner hereof for all other purposes, whether or not this Note be overdue, and neither the Company nor any such agent shall be affected or bound by notice to the contrary. Any Holder of this Note electing to exercise the right of conversion set forth in Section 4(a) hereof, in addition to the requirements set forth in Section 4(a), and any prequalified prospective transferee of this Note, also is required to give the Company written confirmation that this Note is being converted ("Notice of Conversion") in the form annexed hereto as Exhibit A. The date of receipt (including receipt by telecopy) of such Notice of Conversion shall be the Conversion Date. All notices of conversion will be accompanied by an Opinion of Counsel.

4. (a) The Holder of this Note is entitled, at its option, at any time commencing on or after the six month anniversary of the date of payment of the purchase price of this note to the Company by the Holder, to convert all or any amount of the principal face amount of this Note then outstanding into shares of the Company's common stock (the "Common Stock") at a price ("Conversion Price") for each share of Common Stock equal to **62%** of the lowest trading price of the Common Stock as reported on the National Quotations Bureau OTCQB exchange which the Company's shares are traded or any exchange upon which the Common Stock may be traded in the future ("Exchange"), for the twenty-five prior trading days including the day upon which a Notice of Conversion is received by the Company (provided such Notice of Conversion is delivered together with an Opinion of Counsel, by fax or other electronic method of communication to the Company after 4 P.M. Eastern Standard or Daylight Savings Time if the Holder wishes to include the same day closing price). If the shares have not been delivered within 3 business days, the Notice of Conversion may be rescinded. Such conversion shall be effectuated by the Company delivering the shares of Common Stock to the Holder within 3 business days of receipt by the Company of the Notice of Conversion. Accrued, but unpaid interest shall be subject to conversion. No fractional shares or scrip representing fractions of shares will be issued on conversion, but the number of shares issuable shall be rounded to the nearest whole share. To the extent the Conversion Price of the Company's Common Stock closes below the par value per share, the Company will take all steps necessary to solicit the consent of the stockholders to reduce the par value to the lowest value possible under law. The Company agrees to honor all conversions submitted pending this increase. *In the event the Company experiences a DTC "Chill" on its shares, the conversion price shall be decreased to 52% instead of 62% while that "Chill" is in effect.* In no event shall the Holder be allowed to effect a conversion if such conversion, along with all other shares of Company Common Stock beneficially owned by the Holder and its affiliates would exceed 9.9% of the outstanding shares of the Common Stock of the Company.

(b) Interest on any unpaid principal balance of this Note shall be paid at the rate of 10% per annum. Interest shall be paid by the Company in Common Stock ("Interest Shares"). Holder may, at any time commencing on or after the six month anniversary of the date of payment of the purchase price of this note to the Company by the Holder, send in a Notice of Conversion to the Company for Interest Shares based on the formula provided in Section 4(a) above. The dollar amount converted into Interest Shares shall be all or a portion of the accrued interest calculated on the unpaid principal balance of this Note to the date of such notice.

(c) During the first 6 months this Note is in effect, the Company may redeem this Note by paying to the Holder an amount equal to 150% of the face amount plus any accrued interest. This Note may not be prepaid after the 6 month anniversary. The redemption must be closed and paid for within 3 business days of the Company sending the redemption demand or the redemption will be invalid and the Company may not redeem this Note.

(d) Upon (i) a transfer of all or substantially all of the assets of the Company to any person in a single transaction or series of related transactions, (ii) a reclassification, capital reorganization (excluding an increase in authorized capital) or other change or exchange of outstanding shares of the Common Stock, other than a forward or reverse stock split or stock dividend, or (iii) any consolidation or merger of the Company with or into another person or entity in which the Company is not the surviving entity (other than a merger which is effected solely to change the jurisdiction of incorporation of the Company and results in a reclassification, conversion or exchange of outstanding shares of Common Stock solely into shares of Common Stock) (each of items (i), (ii) and (iii) being referred to as a "Sale Event"), then, in each case, the Company shall, upon request of the Holder, redeem this Note in cash for 150% of the principal amount, plus accrued but unpaid interest through the date of redemption, or at the election of the Holder, such Holder may convert the unpaid principal amount of this Note (together with the amount of accrued but unpaid interest) into shares of Common Stock immediately prior to such Sale Event at the Conversion Price.

(e) In case of any Sale Event (not to include a sale of all or substantially all of the Company's assets) in connection with which this Note is not redeemed or converted, the Company shall cause effective provision to be made so that the Holder of this Note shall have the right thereafter, by converting this Note, to purchase or convert this Note into the kind and number of shares of stock or other securities or property (including cash) receivable upon such reclassification, capital reorganization or other change, consolidation or merger by a holder of the number of shares of Common Stock that could have been purchased upon exercise of the Note and at the same Conversion Price, as defined in this Note, immediately prior to such Sale Event. The foregoing provisions shall similarly apply to successive Sale Events. If the consideration received by the holders of Common Stock is other than cash, the value shall be as determined by the Board of Directors of the Company or successor person or entity acting in good faith.

5. No provision of this Note shall alter or impair the obligation of the Company, which is absolute and unconditional, to pay the principal of, and interest on, this Note at the time, place, and rate, and in the form, herein prescribed.

6. The Company hereby expressly waives demand and presentment for payment, notice of non-payment, protest, notice of protest, notice of dishonor, notice of acceleration or intent to accelerate, and diligence in taking any action to collect amounts called for hereunder and shall be directly and primarily liable for the payment of all sums owing and to be owing hereto.

7. The Company agrees to pay all costs and expenses, including reasonable attorneys' fees and expenses, which may be incurred by the Holder in collecting any amount due under this Note.

8. If one or more of the following described "Events of Default" shall occur:

(a) The Company shall default in the payment of principal or interest on this Note or any other note issued to the Holder by the Company; or

(b) Any of the representations or warranties made by the Company herein or in any certificate or financial or other written statements heretofore or hereafter furnished by or on behalf of the Company in connection with the execution and delivery of this Note, or the Securities Purchase Agreement under which this note was issued shall be false or misleading in any respect; or

(c) The Company shall fail to perform or observe, in any respect, any covenant, term, provision, condition, agreement or obligation of the Company under this Note or any other note issued to the Holder; or

(d) The Company shall (1) become insolvent (which does not include a "going concern opinion"); (2) admit in writing its inability to pay its debts generally as they mature; (3) make an assignment for the benefit of creditors or commence proceedings for its dissolution; (4) apply for or consent to the appointment of a trustee, liquidator or receiver for its or for a substantial part of its property or business; (5) file a petition for bankruptcy relief, consent to the filing of such petition or have filed against it an involuntary petition for bankruptcy relief, all under federal or state laws as applicable; or

(e) A trustee, liquidator or receiver shall be appointed for the Company or for a substantial part of its property or business without its consent and shall not be discharged within sixty (60) days after such appointment; or

(f) Any governmental agency or any court of competent jurisdiction at the instance of any governmental agency shall assume custody or control of the whole or any substantial portion of the properties or assets of the Company; or

(g) One or more money judgments, writs or warrants of attachment, or similar process, in excess of one hundred thousand dollars (\$100,000) in the aggregate, shall be entered or filed against the Company or any of its properties or other assets and shall remain unpaid, unvacated, unbonded or unstayed for a period of fifteen (15) days or in any event later than five (5) days prior to the date of any proposed sale thereunder; or

(h) Defaulted on or breached any term of any other note of similar debt instrument into which the Company has entered and failed to cure such default within the appropriate grace period; or

(i) The Company shall have its Common Stock delisted from an exchange (including the OTC Markets exchange) or, if the Common Stock trades on an exchange, then trading in the Common Stock shall be suspended for more than 10 consecutive days or ceases to file its 1934 act reports with the SEC;

(j) Intentional Deleted;

(k) The Company shall not deliver to the Holder the Common Stock pursuant to paragraph 4 herein without restrictive legend within 3 business days of its receipt of a properly executed Notice of Conversion which includes an acceptable Opinion of Counsel expressing an opinion which supports the removal of a restrictive legend; or

(l) The Company shall not replenish the reserve set forth in Section 12, within 3 business days of the request of the Holder.

(m) The Company shall be delinquent in its periodic report filings with the Securities and Exchange Commission; or

(n) The Company shall cause to lose the "bid" price for its stock in a market (including the OTCQB marketplace or other exchange).

Then, or at any time thereafter, unless cured within 5 days, and in each and every such case, unless such Event of Default shall have been waived in writing by the Holder (which waiver shall not be deemed to be a waiver of any subsequent default) at the option of the Holder and in the Holder's sole discretion, the Holder may consider this Note immediately due and payable, without presentment, demand, protest or (further) notice of any kind (other than notice of acceleration), all of which are hereby expressly waived, anything herein or in any note or other instruments contained to the contrary notwithstanding, and the Holder may immediately, and without expiration of any period of grace, enforce any and all of the Holder's rights and remedies provided herein or any other rights or remedies afforded by law. Upon an Event of Default, interest shall accrue at a default interest rate of 24% per annum or, if such rate is usurious or not permitted by current law, then at the highest rate of interest permitted by law. In the event of a breach of Section 8(k) the penalty shall be \$250 per day the shares are not issued beginning on the 4<sup>th</sup> day after the conversion notice was delivered to the Company. This penalty shall increase to \$500 per day beginning on the 10<sup>th</sup> day. The penalty for a breach of Section 8(n) shall be an increase of the outstanding principal amounts by 20%. In case of a breach of Section 8(i), the outstanding principal due under this Note shall increase by 50%. If this Note is not paid at maturity, the outstanding principal due under this Note shall increase by 10%. Further, if a breach of Section 8(m) occurs or is continuing after the 6 month anniversary of the Note, then the Holder shall be entitled to use the lowest closing bid price during the delinquency period as a base price for the conversion. For example, if the lowest closing bid price during the delinquency period is \$0.01 per share and the conversion discount is 50% the Holder may elect to convert future conversions at \$0.005 per share.

If the Holder shall commence an action or proceeding to enforce any provisions of this Note, including, without limitation, engaging an attorney, then if the Holder prevails in such action, the Holder shall be reimbursed by the Company for its attorneys' fees and other costs and expenses incurred in the investigation, preparation and prosecution of such action or proceeding.

Make-Whole for Failure to Deliver Loss. At the Holder's election, if the Company fails for any reason to deliver to the Holder the conversion shares by the by the 3rd business day following the delivery of a Notice of Conversion to the Company and if the Holder incurs a Failure to Deliver Loss, then at any time the Holder may provide the Company written notice indicating the amounts payable to the Holder in respect of the Failure to Deliver Loss and the Company must make the Holder whole as follows:

Failure to Deliver Loss = [(High trade price at any time on or after the day of exercise) x (Number of conversion shares)]

The Company must pay the Failure to Deliver Loss by cash payment, and any such cash payment must be made by the third business day from the time of the Holder's written notice to the Company.

9. In case any provision of this Note is held by a court of competent jurisdiction to be excessive in scope or otherwise invalid or unenforceable, such provision shall be adjusted rather than voided, if possible, so that it is enforceable to the maximum extent possible, and the validity and enforceability of the remaining provisions of this Note will not in any way be affected or impaired thereby.

10. Neither this Note nor any term hereof may be amended, waived, discharged or terminated other than by a written instrument signed by the Company and the Holder.

11. The Company represents that it is not a "shell" issuer and that if it previously has been a "shell" issuer that at least 12 months have passed since the Company has reported Form 10 type information indicating it is no longer a "shell issuer."

12. The Company shall internally reserve 100,000,000 shares of its Common Stock for conversions under this Note (the "Share Reserve"). Upon full conversion of this Note, any shares remaining in the Share Reserve shall be cancelled. The Company shall pay all transfer agent costs associated with issuing and delivering the share certificates to Holder. If such amounts are to be paid by the Holder, it may deduct such amounts from the Conversion Price. The company should at all times reserve a minimum of four times the amount of shares required if the note would be fully converted. The Holder may reasonably request increases from time to time to reserve such amounts. The Company will instruct its transfer agent to provide the outstanding share information to the Holder in connection with its conversions.

13. The Company will give the Holder direct notice of any corporate actions, including but not limited to name changes, stock splits, recapitalizations etc. This notice shall be given to the Holder as soon as possible under law.

14. This Note shall be governed by and construed in accordance with the laws of New York applicable to contracts made and wholly to be performed within the State of New York and shall be binding upon the successors and assigns of each party hereto. The Holder and the Company hereby mutually waive trial by jury and consent to exclusive jurisdiction and venue in the courts of the State of New York. This Agreement may be executed in counterparts, and the facsimile transmission of an executed counterpart to this Agreement shall be effective as an original.

IN WITNESS WHEREOF, the Company has caused this Note to be duly executed by an officer thereunto duly authorized.

Dated: November 12, 2016

COATES INTERNATIONAL, LTD.

By: /s/ Barry C. Kaye  
Barry C. Kaye  
Chief Financial Officer

**EXHIBIT A**

**NOTICE OF CONVERSION**

(To be Executed by the Registered Holder in order to Convert the Note)

The undersigned hereby irrevocably elects to convert \$\_\_\_\_\_ of the above Note into \_\_\_\_\_ Shares of Common Stock of Coates International, Ltd. ("Shares") according to the conditions set forth in such Note, as of the date written below.

If Shares are to be issued in the name of a person other than the undersigned, the undersigned will pay all transfer and other taxes and charges payable with respect thereto.

Date of Conversion: \_\_\_\_\_

Applicable Conversion Price: \_\_\_\_\_

Signature: \_\_\_\_\_

[Print Name of Holder and Title of Signer]

Address: \_\_\_\_\_

\_\_\_\_\_

SSN or EIN: \_\_\_\_\_

Shares are to be registered in the following name: \_\_\_\_\_

Name: \_\_\_\_\_

Address: \_\_\_\_\_

Tel: \_\_\_\_\_

Fax: \_\_\_\_\_

SSN or EIN: \_\_\_\_\_

Shares are to be sent or delivered to the following account:

Account Name: \_\_\_\_\_

Address: \_\_\_\_\_

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## SECURITIES PURCHASE AGREEMENT

This **SECURITIES PURCHASE AGREEMENT** (the “Agreement”), dated as of February 12, 2016, by and between **Coates International, Ltd.**, a Delaware corporation, with headquarters located at Highway 34 & Ridgewood Road, Wall Township, NJ 07719, (the “Company”), and **APG CAPITAL HOLDINGS, LLC**, a New York limited liability company, with its address at 300 Cadman Plaza West, 12<sup>th</sup> Floor, Brooklyn, NY 11201 (the “Buyer”).

**WHEREAS:**

A. The Company and the Buyer are executing and delivering this Agreement in reliance upon the exemption from securities registration afforded by the rules and regulations as promulgated by the United States Securities and Exchange Commission (the “SEC”) under the Securities Act of 1933, as amended (the “1933 Act”);

B. Buyer desires to purchase and the Company desires to issue and sell, upon the terms and conditions set forth in this Agreement a 10% convertible note of the Company, in the form attached hereto as Exhibit A in the aggregate principal amount of \$33,000.00 (together with any note(s) issued in replacement thereof or as a dividend thereon or otherwise with respect thereto in accordance with the terms thereof, the “Note”), convertible into shares of common stock, of the Company (the “Common Stock”), upon the terms and subject to the limitations and conditions set forth in such Note.

C. The Buyer wishes to purchase, upon the terms and conditions stated in this Agreement, such principal amount of Note as is set forth immediately below its name on the signature pages hereto; and

**NOW THEREFORE**, the Company and the Buyer severally (and not jointly) hereby agree as follows:

1. Purchase and Sale of Note.

a. Purchase of Note. On the Closing Date (as defined below), the Company shall issue and sell to the Buyer and the Buyer agrees to purchase from the Company such principal amount of Note as is set forth immediately below the Buyer’s name on the signature pages hereto.

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b. Form of Payment. On the Closing Date (as defined below), (i) the Buyer shall pay the purchase price for the Note to be issued and sold to it at the Closing (as defined below) (the "Purchase Price") by wire transfer of immediately available funds to the Company, in accordance with the Company's written wiring instructions, against delivery of the Note in the principal amount equal to the Purchase Price as is set forth immediately below the Buyer's name on the signature pages hereto, and (ii) the Company shall deliver such duly executed Note on behalf of the Company, to the Buyer, against delivery of such Purchase Price.

c. Closing Date. The date and time of the first issuance and sale of the Note pursuant to this Agreement (the "Closing Date") shall be on or about February 12, 2016, or such other mutually agreed upon time. The closing of the transactions contemplated by this Agreement (the "Closing") shall occur on the Closing Date at such location as may be agreed to by the parties.

2. Buyer's Representations and Warranties. The Buyer represents and warrants to the Company that:

a. Investment Purpose. As of the date hereof, the Buyer is purchasing the Note and the shares of Common Stock issuable upon conversion of or otherwise pursuant to the Note, such shares of Common Stock being collectively referred to herein as the "Conversion Shares" and, collectively with the Note, the "Securities") for its own account and not with a present view towards the public sale or distribution thereof, except pursuant to sales registered or exempted from registration under the 1933 Act; provided, however, that by making the representations herein, the Buyer does not agree to hold any of the Securities for any minimum or other specific term and reserves the right to dispose of the Securities at any time in accordance with or pursuant to a registration statement or an exemption under the 1933 Act.

b. Accredited Investor Status. The Buyer is an "accredited investor" as that term is defined in Rule 501(a) of Regulation D (an "Accredited Investor"). Any of Buyer's transferees, assignees, or purchasers must be "accredited investors" in order to qualify as prospective transferees, permitted assignees in the case of Buyer's or Holder's transfer, assignment or sale of the Note.

c. Reliance on Exemptions. The Buyer understands that the Securities are being offered and sold to it in reliance upon specific exemptions from the registration requirements of United States federal and state securities laws and that the Company is relying upon the truth and accuracy of, and the Buyer's compliance with, the representations, warranties, agreements, acknowledgments and understandings of the Buyer set forth herein in order to determine the availability of such exemptions and the eligibility of the Buyer to acquire the Securities.

d. Information. The Buyer and its advisors, if any, have been, and for so long as the Note remain outstanding will continue to be, furnished with all materials relating to the business, finances and operations of the Company and materials relating to the offer and sale of the Securities which have been requested by the Buyer or its advisors. The Buyer and its advisors, if any, have been, and for so long as the Note remain outstanding will continue to be, afforded the opportunity to ask questions of the Company. Notwithstanding the foregoing, the Company has not disclosed to the Buyer any material nonpublic information and will not disclose such information unless such information is disclosed to the public prior to or promptly following such disclosure to the Buyer. Neither such inquiries nor any other due diligence investigation conducted by Buyer or any of its advisors or representatives shall modify, amend or affect Buyer's right to rely on the Company's representations and warranties contained in Section 3 below. The Buyer understands that its investment in the Securities involves a significant degree of risk. The Buyer is not aware of any facts that may constitute a breach of any of the Company's representations and warranties made herein.

e. Governmental Review. The Buyer understands that no United States federal or state agency or any other government or governmental agency has passed upon or made any recommendation or endorsement of the Securities.

f. Transfer or Re-sale. The Buyer understands that (i) the sale or re-sale of the Securities has not been and is not being registered under the 1933 Act or any applicable state securities laws, and the Securities may not be transferred unless (a) the Securities are sold pursuant to an effective registration statement under the 1933 Act, (b) in the case of subparagraphs (c), (d) and (e) below, the Buyer shall have delivered to the Company, at the cost of the Buyer, an opinion of counsel that shall be in form, substance and scope customary for opinions of counsel in comparable transactions to the effect that the Securities to be sold or transferred may be sold, or transferred pursuant to an exemption from such registration, including the removal of any restrictive legend which opinion shall be accepted by the Company, (c) the Securities are sold or transferred to an "affiliate" (as defined in Rule 144 promulgated under the 1933 Act (or a successor rule) ("Rule 144") of the Buyer who agrees to sell or otherwise transfer the Securities only in accordance with this Section 2(f) and who is an Accredited Investor, (d) the Securities are sold pursuant to Rule 144, or (e) the Securities are sold pursuant to Regulation S under the 1933 Act (or a successor rule) ("Regulation S"); (ii) any sale of such Securities made in reliance on Rule 144 may be made only in accordance with the terms of said Rule and further, if said Rule is not applicable, any re-sale of such Securities under circumstances in which the seller (or the person through whom the sale is made) may be deemed to be an underwriter (as that term is defined in the 1933 Act) may require compliance with some other exemption under the 1933 Act or the rules and regulations of the SEC thereunder; and (iii) neither the Company nor any other person is under any obligation to register such Securities under the 1933 Act or any state securities laws or to comply with the terms and conditions of any exemption thereunder (in each case). Notwithstanding the foregoing or anything else contained herein to the contrary, the Securities may be pledged as collateral in connection with a bona fide margin account or other lending arrangement.

g. Legends. The Buyer understands that the Note and, until such time as the Conversion Shares have been registered under the 1933 Act will be sold pursuant to Rule 144 or Regulation S without any restriction as to the number of securities as of a particular date that can then be immediately sold, the Conversion Shares may bear a restrictive legend in substantially the following form (and a stop-transfer order may be placed against transfer of the certificates for such Securities):

**“NEITHER THE ISSUANCE AND SALE OF THE SECURITIES REPRESENTED BY THIS CERTIFICATE NOR THE SECURITIES INTO WHICH THESE SECURITIES ARE EXERCISABLE HAVE BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR APPLICABLE STATE SECURITIES LAWS. THE SECURITIES MAY NOT BE OFFERED FOR SALE, SOLD, TRANSFERRED OR ASSIGNED (I) IN THE ABSENCE OF (A) AN EFFECTIVE REGISTRATION STATEMENT FOR THE SECURITIES UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR (B) AN OPINION OF COUNSEL (WHICH COUNSEL SHALL BE SELECTED BY THE HOLDER), IN A GENERALLY ACCEPTABLE FORM, THAT REGISTRATION IS NOT REQUIRED UNDER SAID ACT OR (II) UNLESS SOLD PURSUANT TO RULE 144 OR RULE 144A UNDER SAID ACT. NOTWITHSTANDING THE FOREGOING, THE SECURITIES MAY BE PLEDGED IN CONNECTION WITH A BONA FIDE MARGIN ACCOUNT OR OTHER LOAN OR FINANCING ARRANGEMENT SECURED BY THE SECURITIES.”**

The legend set forth above shall be removed and the Company shall issue a certificate without such legend to the holder of any Security upon which it is stamped, if, unless otherwise required by applicable state securities laws, (a) such Security is registered for sale under an effective registration statement filed under the 1933 Act or otherwise may be sold pursuant to Rule 144 or Regulation S without any restriction as to the number of securities as of a particular date that can then be immediately sold, and (b) such holder provides the Company with an opinion of counsel, in form, substance and scope customary for opinions of counsel in comparable transactions, to the effect that a public sale or transfer of such Security may be made without registration under the 1933 Act, and that legend removal is appropriate, which opinion shall be accepted by the Company so that the sale or transfer is effected. The Buyer agrees to sell all Securities, including those represented by a certificate(s) from which the legend has been removed, in compliance with applicable prospectus delivery requirements, if any. In the event that the Company does not accept the opinion of counsel provided by the Buyer with respect to the transfer of Securities pursuant to an exemption from registration, such as Rule 144 or Regulation S, within 2 business days, it will be considered an Event of Default under the Note.

h. Authorization; Enforcement. This Agreement has been duly and validly authorized. This Agreement has been duly executed and delivered on behalf of the Buyer, and this Agreement constitutes a valid and binding agreement of the Buyer enforceable in accordance with its terms.

i. Residency. The Buyer is a resident of the jurisdiction set forth immediately below the Buyer’s name on the signature pages hereto.

j. No Short Sales. Buyer/Holder, its successors and assigns, agree that so long as the Note remains outstanding, the Buyer/Holder shall not enter into or effect “short sales” of the Common Stock or hedging transaction which establishes a short position with respect to the Common Stock of the Company. The Company acknowledges and agrees that upon delivery of a Conversion Notice by the Buyer/Holder, the Buyer/Holder immediately owns the shares of Common Stock described in the Conversion Notice and any sale of those shares issuable under such Conversion Notice would not be considered short sales.

3. Representations and Warranties of the Company. The Company represents and warrants to the Buyer that:

a. Organization and Qualification. The Company and each of its subsidiaries, if any, is a corporation duly organized, validly existing and in good standing under the laws of the jurisdiction in which it is incorporated, with full power and authority (corporate and other) to own, lease, use and operate its properties and to carry on its business as and where now owned, leased, used, operated and conducted.

b. Authorization; Enforcement. (i) The Company has all requisite corporate power and authority to enter into and perform this Agreement, the Note and to consummate the transactions contemplated hereby and thereby and to issue the Securities, in accordance with the terms hereof and thereof, (ii) the execution and delivery of this Agreement, the Note by the Company and the consummation by it of the transactions contemplated hereby and thereby (including without limitation, the issuance of the Note and the issuance and reservation for issuance of the Conversion Shares issuable upon conversion or exercise thereof) have been duly authorized by the Company's Board of Directors and no further consent or authorization of the Company, its Board of Directors, or its shareholders is required, (iii) this Agreement has been duly executed and delivered by the Company by its authorized representative, and such authorized representative is the true and official representative with authority to sign this Agreement and the other documents executed in connection herewith and bind the Company accordingly, and (iv) this Agreement constitutes, and upon execution and delivery by the Company of the Note, each of such instruments will constitute, a legal, valid and binding obligation of the Company enforceable against the Company in accordance with its terms.

c. Issuance of Shares. The Conversion Shares are duly authorized and reserved for issuance and, upon conversion of the Note in accordance with its respective terms, will be validly issued, fully paid and non-assessable, and free from all taxes, liens, claims and encumbrances with respect to the issue thereof and shall not be subject to preemptive rights or other similar rights of shareholders of the Company and will not impose personal liability upon the holder thereof.

d. Acknowledgment of Dilution. The Company understands and acknowledges the potentially dilutive effect to the Common Stock upon the issuance of the Conversion Shares upon conversion of the Note. The Company further acknowledges that its obligation to issue Conversion Shares upon conversion of the Note in accordance with this Agreement, the Note is absolute and unconditional regardless of the dilutive effect that such issuance may have on the ownership interests of other shareholders of the Company.

e. No Conflicts. The execution, delivery and performance of this Agreement, the Note by the Company and the consummation by the Company of the transactions contemplated hereby and thereby (including, without limitation, the issuance and reservation for issuance of the Conversion Shares) will not (i) conflict with or result in a violation of any provision of the Certificate of Incorporation or By-laws, or (ii) violate or conflict with, or result in a breach of any provision of, or constitute a default (or an event which with notice or lapse of time or both could become a default) under, or give to others any rights of termination, amendment, acceleration or cancellation of, any agreement, indenture, patent, patent license or instrument to which the Company or any of its subsidiaries is a party, or (iii) result in a violation of any law, rule, regulation, order, judgment or decree (including federal and state securities laws and regulations and regulations of any self-regulatory organizations to which the Company or its securities are subject) applicable to the Company or any of its subsidiaries or by which any property or asset of the Company or any of its subsidiaries is bound or affected (except for such conflicts, defaults, terminations, amendments, accelerations, cancellations and violations as would not, individually or in the aggregate, have a material adverse effect). All consents, authorizations, orders, filings and registrations which the Company is required to obtain pursuant to the preceding sentence have been obtained or effected on or prior to the date hereof. The Company is not in violation of the listing requirements of the OTC marketplace (the "OTC MARKETPLACE") and does not reasonably anticipate that the Common Stock will be delisted by the OTC MARKETPLACE in the foreseeable future, nor are the Company's securities "chilled" by DTC. The Company and its subsidiaries are unaware of any facts or circumstances which might give rise to any of the foregoing.

f. Absence of Litigation. Except as disclosed in the Company's Periodic Report filings with the SEC, there is no action, suit, claim, proceeding, inquiry or investigation before or by any court, public board, government agency, self-regulatory organization or body pending or, to the knowledge of the Company or any of its subsidiaries, threatened against or affecting the Company or any of its subsidiaries, or their officers or directors in their capacity as such, that could have a material adverse effect. Schedule 3(f) contains a complete list and summary description of any pending or, to the knowledge of the Company, threatened proceeding against or affecting the Company or any of its subsidiaries, without regard to whether it would have a material adverse effect. The Company and its subsidiaries are unaware of any facts or circumstances which might give rise to any of the foregoing.

g. Acknowledgment Regarding Buyer' Purchase of Securities. The Company acknowledges and agrees that the Buyer is acting solely in the capacity of arm's length purchasers with respect to this Agreement and the transactions contemplated hereby. The Company further acknowledges that the Buyer is not acting as a financial advisor or fiduciary of the Company (or in any similar capacity) with respect to this Agreement and the transactions contemplated hereby and any statement made by the Buyer or any of its respective representatives or agents in connection with this Agreement and the transactions contemplated hereby is not advice or a recommendation and is merely incidental to the Buyer' purchase of the Securities. The Company further represents to the Buyer that the Company's decision to enter into this Agreement has been based solely on the independent evaluation of the Company and its representatives.

h. No Integrated Offering. Neither the Company, nor any of its affiliates, nor any person acting on its or their behalf, has directly or indirectly made any offers or sales in any security or solicited any offers to buy any security under circumstances that would require registration under the 1933 Act of the issuance of the Securities to the Buyer.

i. Title to Property. The Company and its subsidiaries have good and marketable title in fee simple to all real property and good and marketable title to all personal property owned by them which is material to the business of the Company and its subsidiaries, in each case free and clear of all liens, encumbrances and defects except such as are disclosed in the Company's quarterly report on Form 10-Q filed with the Securities and Exchange Commission on November 12, 2015 or such as would not have a material adverse effect. Any real property and facilities held under lease by the Company and its subsidiaries are held by them under valid, subsisting and enforceable leases with such exceptions as would not have a material adverse effect.

j. Bad Actor. No officer or director of the Company would be disqualified under Rule 506(d) of the Securities Act as amended on the basis of being a "bad actor" as that term is established in the September 19, 2013 Small Entity Compliance Guide published by the Securities and Exchange Commission.

k. Breach of Representations and Warranties by the Company. If the Company breaches any of the representations or warranties set forth in this Section 3, and in addition to any other remedies available to the Buyer pursuant to this Agreement, it will be considered an Event of default under the Note.

#### 4. COVENANTS.

a. Expenses. At the Closing, the Company shall reimburse Buyer for no more than \$2,000 of expenses incurred by them in connection with the negotiation, preparation, execution, delivery and performance of this Agreement and the other agreements to be executed in connection herewith ("Documents"), including, without limitation, reasonable attorneys' and consultants' fees and expenses, transfer agent fees, fees for stock quotation services, fees relating to any amendments or modifications of the Documents or any consents or waivers of provisions in the Documents, fees for the preparation of opinions of counsel, escrow fees, and costs of restructuring the transactions contemplated by the Documents. When possible, the Company must pay these fees directly, otherwise the Company must make immediate payment for reimbursement to the Buyer for all fees and expenses immediately upon written notice by the Buyer or the submission of an invoice by the Buyer. The Company shall also be responsible for all transfer agent fees relating to the issuance of the shares issuable upon conversion of the Note.

b. Listing. The Company shall promptly secure the listing of the Conversion Shares upon each national securities exchange or automated quotation system, if any, upon which shares of Common Stock are then listed (subject to official notice of issuance) and, so long as the Buyer owns any of the Note Securities, shall maintain, so long as any other shares of Common Stock shall be so listed, such listing of all Conversion Shares from time to time issuable upon conversion of the Note. The Company will obtain and, so long as the Buyer owns any of the Securities, maintain the listing and trading of its Common Stock on the OTC MARKETPLACE or any equivalent replacement market, the Nasdaq stock market (“Nasdaq”), the New York Stock Exchange (“NYSE”), or the American Stock Exchange (“AMEX”) and will comply in all respects with the Company’s reporting, filing and other obligations under the bylaws or rules of the Financial Industry Regulatory Authority (“FINRA”) and such exchanges, as applicable. The Company shall promptly provide to the Buyer copies of any notices it receives from the OTC MARKETPLACE and any other markets on which the Common Stock is then listed regarding the continued eligibility of the Common Stock for listing on such markets.

c. Corporate Existence. So long as the Buyer beneficially owns the Note, the Company shall maintain its corporate existence and shall not sell all or substantially all of the Company’s assets, except in the event of a merger or consolidation or sale of all or substantially all of the Company’s assets, where the surviving or successor entity in such transaction (i) assumes the Company’s obligations hereunder and under the agreements and instruments entered into in connection herewith and (ii) is a publicly traded corporation whose Common Stock is listed for trading on the OTC MARKETPLACE, Nasdaq, NYSE or AMEX.

d. No Integration. The Company shall not make any offers or sales of any security (other than the Securities) under circumstances that would require registration of the Securities being offered or sold hereunder under the 1933 Act or cause the offering of the Securities to be integrated with any other offering of securities by the Company for the purpose of any stockholder approval provision applicable to the Company or its securities.

e. Breach of Covenants. If the Company breaches any of the covenants set forth in this Section 4, and in addition to any other remedies available to the Buyer pursuant to this Agreement, it will be considered an event of default under the Note.

5. Governing Law; Miscellaneous.

a. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of New York without regard to principles of conflicts of laws. Any action brought by either party against the other concerning the transactions contemplated by this Agreement shall be brought only in the state courts of New York or in the federal courts located in the state and county of New York. The parties to this Agreement hereby irrevocably waive any objection to jurisdiction and venue of any action instituted hereunder and shall not assert any defense based on lack of jurisdiction or venue or based upon *forum non conveniens*. The Company and Buyer waive trial by jury. The prevailing party shall be entitled to recover from the other party its reasonable attorney’s fees and costs. In the event that any provision of this Agreement or any other agreement delivered in connection herewith is invalid or unenforceable under any applicable statute or rule of law, then such provision shall be deemed inoperative to the extent that it may conflict therewith and shall be deemed modified to conform with such statute or rule of law. Any such provision which may prove invalid or unenforceable under any law shall not affect the validity or enforceability of any other provision of any agreement. Each party hereby irrevocably waives personal service of process and consents to process being served in any suit, action or proceeding in connection with this Agreement or any other Transaction Document by mailing a copy thereof via registered or certified mail or overnight delivery (with evidence of delivery) to such party at the address in effect for notices to it under this Agreement and agrees that such service shall constitute good and sufficient service of process and notice thereof. Nothing contained herein shall be deemed to limit in any way any right to serve process in any other manner permitted by law.



b. Counterparts; Signatures by Facsimile. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original but all of which shall constitute one and the same agreement and shall become effective when counterparts have been signed by each party and delivered to the other party. This Agreement, once executed by a party, may be delivered to the other party hereto by facsimile transmission of a copy of this Agreement bearing the signature of the party so delivering this Agreement.

c. Headings. The headings of this Agreement are for convenience of reference only and shall not form part of, or affect the interpretation of, this Agreement.

d. Severability. In the event that any provision of this Agreement is invalid or unenforceable under any applicable statute or rule of law, then such provision shall be deemed inoperative to the extent that it may conflict therewith and shall be deemed modified to conform with such statute or rule of law. Any provision hereof which may prove invalid or unenforceable under any law shall not affect the validity or enforceability of any other provision hereof.

e. Entire Agreement; Amendments. This Agreement and the instruments referenced herein contain the entire understanding of the parties with respect to the matters covered herein and therein and, except as specifically set forth herein or therein, neither the Company nor the Buyer makes any representation, warranty, covenant or undertaking with respect to such matters. No provision of this Agreement may be waived or amended other than by an instrument in writing signed by the majority in interest of the Buyer.

f. Notices. All notices, demands, requests, consents, approvals, and other communications required or permitted hereunder shall be in writing and, unless otherwise specified herein, shall be (i) personally served, (ii) deposited in the mail, registered or certified, return receipt requested, postage prepaid, (iii) delivered by reputable air courier service with charges prepaid, (iv) via electronic mail or (v) transmitted by hand delivery, telegram, or facsimile, addressed as set forth below or to such other address as such party shall have specified most recently by written notice. Any notice or other communication required or permitted to be given hereunder shall be deemed effective (a) upon hand delivery or delivery by facsimile, with accurate confirmation generated by the transmitting facsimile machine, at the address or number designated below (if delivered on a business day during normal business hours where such notice is to be received) or delivery via electronic mail, or the first business day following such delivery (if delivered other than on a business day during normal business hours where such notice is to be received) or (b) on the second business day following the date of mailing by express courier service, fully prepaid, addressed to such address, or upon actual receipt of such mailing, whichever shall first occur. The addresses for such communications shall be:

g.

If to the Company, to:  
Coates International, Ltd.  
Highway 34 & Ridgewood Road,  
Wall Township, NJ 07719  
Attn: Barry C. Kaye, CFO

If to the Buyer:  
APG CAPITAL HOLDINGS, LLC  
300 Cadman Plaza West, 12<sup>th</sup> Floor  
Brooklyn, NY 11201  
Attn: Finance

Each party shall provide notice to the other party of any change in address.

h. Successors and Assigns. This Agreement shall be binding upon and inure to the benefit of the parties and their successors and assigns. Neither the Company nor the Buyer shall assign this Agreement or any rights or obligations hereunder without the prior written consent of the other. Notwithstanding the foregoing, the Buyer may assign its rights hereunder to any “qualified person”, any “permitted assigns”, or “prospective transferee” that acquires or purchases Note Securities in a private transaction from the Buyer or to any of its “affiliates,” as that term is defined under the 1934 Act, with the prior written consent of the Company, which consent shall not be unreasonably withheld, and with Buyer’s Opinion of Counsel. A qualified person is an “accredited investor” transferee, assignee, or purchaser of the Note who succeeds to the Holder’s right, title and interest to all or a portion of the Note accompanied with an Opinion of Counsel as provided for in Section 2(f).

i. Third Party Beneficiaries. This Agreement is intended for the benefit of the parties hereto and their respective permitted successors and assigns, and is not for the benefit of, nor may any provision hereof be enforced by, any other person.

j. Survival. The representations and warranties of the Company and the agreements and covenants set forth in this Agreement shall survive the closing hereunder notwithstanding any due diligence investigation conducted by or on behalf of the Buyer. The Company agrees to indemnify and hold harmless the Buyer and all their officers, directors, employees and agents for loss or damage arising as a result of or related to any breach or alleged breach by the Company of any of its representations, warranties and covenants set forth in this Agreement or any of its covenants and obligations under this Agreement, including advancement of expenses as they are incurred.

k. Further Assurances. Each party shall do and perform, or cause to be done and performed, all such further acts and things, and shall execute and deliver all such other agreements, certificates, instruments and documents, as the other party may reasonably request in order to carry out the intent and accomplish the purposes of this Agreement and the consummation of the transactions contemplated hereby.

l. No Strict Construction. The language used in this Agreement will be deemed to be the language chosen by the parties to express their mutual intent, and no rules of strict construction will be applied against any party.

m. Remedies. The Company acknowledges that a breach by it of its obligations hereunder will cause irreparable harm to the Buyer by vitiating the intent and purpose of the transaction contemplated hereby. Accordingly, the Company acknowledges that the remedy at law for a breach of its obligations under this Agreement will be inadequate and agrees, in the event of a breach or threatened breach by the Company of the provisions of this Agreement, that the Buyer shall be entitled, in addition to all other available remedies at law or in equity, and in addition to the penalties assessable herein, to an injunction or injunctions restraining, preventing or curing any breach of this Agreement and to enforce specifically the terms and provisions hereof, without the necessity of showing economic loss and without any bond or other security being required.

IN WITNESS WHEREOF, the undersigned Buyer and the Company have caused this Agreement to be duly executed as of the date first above written.

**Coates International, Ltd.**

By: /s/ Barry C. Kaye  
Name: Barry C. Kaye  
Title: CFO

**APG CAPITAL HOLDINGS, LLC.**

By: /s/ Nochum Greenberg  
Name: Nochum Greenberg  
Title: Manager

**AGGREGATE SUBSCRIPTION AMOUNT:**

Aggregate Principal Amount of Note: \$33,000.00

Aggregate Purchase Price:

Note: \$33,000.00, less \$2,000.00 in legal fees

**EXHIBIT A**  
**144 NOTE - \$33,000**

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**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER  
PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO SECTION 302 OF THE  
SARBANES-OXLEY ACT OF 2002.**

I, George J. Coates, President and Chief Executive Officer, certify that:

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

Date: April 14, 2016

/s/ George J. Coates

George J. Coates  
President and Chief Executive Officer  
(Principal Executive Officer)

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER  
PURSUANT TO SECTION 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO SECTION 302 OF  
THE SARBANES-OXLEY ACT OF 2002.**

I, Barry C. Kaye, Treasurer and Chief Financial Officer, certify that:

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

Date: April 14, 2016

/s/ Barry C. Kaye

Barry C. Kaye  
Chief Financial Officer  
(Principal Financial Officer)

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Coates International, Ltd. (the "Company") on Form 10-K for the year ended December 31, 2015 (the "Report"), I, George J. Coates, Chief Executive Officer of the Company, certify, to the best of my knowledge, as of the date hereof, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: April 14, 2016

/s/ George J. Coates

George J. Coates  
President and Chief Executive Officer  
(Principal Executive Officer )

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Coates International, Ltd. (the "Company") on Form 10-K for the year ended December 31, 2015 (the "Report"), I, Barry C. Kaye, Chief Financial Officer of the Company, certify, to the best of my knowledge, as of the date hereof, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: April 14, 2016

/s/ Barry C. Kaye

Barry C. Kaye  
Treasurer and Chief Financial Officer  
(Principal Financial Officer)