

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended **September 30, 2012**

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE 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

(State or other jurisdiction of
incorporation or organization)

22-2925432

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

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

(Address of principal executive offices) (Zip Code)

n/a

(Former name, former address and former fiscal year, if changed since last report)

(732) 449-7717

(Registrant's telephone number including area code)

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 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.

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Non-accelerated filer	<input type="checkbox"/>
(Do not check if a smaller reporting company)		Smaller reporting company	<input checked="" type="checkbox"/>

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

As of November 12, 2012, 322,717,738 shares of the Registrant's common stock, par value \$0.001 per share were issued and outstanding.

COATES INTERNATIONAL, LTD.
QUARTERLY REPORT ON FORM 10-Q

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SEPTEMBER 30, 2012

This quarterly report was initially required to be filed by November 14, 2012. The Securities and Exchange Commission issued Release No. 68224 under the Securities Exchange Act of 1934 which was intended to provide relief to public companies affected by the super storm known as Hurricane Sandy. This release extended the date for timely filing of this quarterly report to November 21, 2012 for companies that experienced disruption to their business from this storm. Therefore, this quarterly report has been filed on a timely basis. A total disruption to our business and operations resulted from the storm which made landfall on October 30, 2012 in Monmouth County, New Jersey where the Company's headquarters are located. This included complete loss of electrical power and communications systems, among other things for almost eight consecutive days. Our employees also experienced a complete loss of electrical power and communications systems. Although we experienced this extended business interruption, our headquarters facility did not sustain any damage.

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

**Coates International, Ltd.
Consolidated Balance Sheets**

	September 30, 2012	December 31, 2011
	(Unaudited)	
Assets		
Current Assets		
Cash	\$ 16,115	\$ 52,955
Inventory, net	347,085	387,483
Deferred offering costs	13,769	33,969
Total Current Assets	<u>376,969</u>	<u>474,407</u>
Property, plant and equipment, net	2,257,531	2,303,073
Deferred licensing costs, net	56,370	59,583
Total Assets	<u><u>\$ 2,690,870</u></u>	<u><u>\$ 2,837,063</u></u>
Liabilities and Stockholders' Deficiency		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 1,585,228	\$ 1,304,309
Mortgage loan payable	1,590,000	1,630,000
Deferred stock-based compensation payable	150,600	451,800
Promissory notes to related parties	471,195	447,440
Convertible promissory notes, net of unamortized discount	55,758	111,775
Derivative liability related to convertible promissory notes	281,074	243,306
Unearned revenue	29,124	29,124
10% Convertible note	10,000	10,000
Total Current Liabilities	<u>4,172,979</u>	<u>4,227,754</u>
License deposits	346,200	360,600
Total Liabilities	<u>4,519,179</u>	<u>4,588,354</u>
Commitments and Contingencies		
Stockholders' Deficiency		
Preferred Stock, \$0.001 par value, 100,000,000 shares authorized, 72,883 shares issued and outstanding at September 30, 2012 and December 31, 2011.	73	73
Common Stock, \$0.0001 par value, 1,000,000,000 shares authorized, 317,084,135 and 284,127,846 shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively	31,708	28,413
Additional paid-in capital	28,529,025	24,917,261
Accumulated deficit	<u>(30,389,115)</u>	<u>(26,697,038)</u>
Total Stockholders' Deficiency	<u>(1,828,309)</u>	<u>(1,751,291)</u>
Total Liabilities and Stockholders' Deficiency	<u><u>\$ 2,690,870</u></u>	<u><u>\$ 2,837,063</u></u>

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

Coates International, Ltd.
Consolidated Statements of Operations
Unaudited

	<u>For the Three Months Ended</u> <u>September 30,</u>		<u>For the Nine Months Ended</u> <u>September 30,</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Sales	\$ -	\$ -	\$ -	\$ 125,000
Costs of Goods Sold	-	-	-	65,446
Gross Margin	-	-	-	59,554
Revenue from research and development	-	-	-	150,000
Sublicensing fee revenue	4,800	4,800	14,400	9,600
Total Revenues	<u>4,800</u>	<u>4,800</u>	<u>14,400</u>	<u>219,154</u>
Expenses:				
Research and development costs	94,021	95,879	415,879	171,694
General and administrative expenses	571,213	369,368	2,835,691	1,233,988
Depreciation and amortization	22,173	17,101	48,754	52,827
	<u>687,407</u>	<u>482,348</u>	<u>3,300,324</u>	<u>1,458,509</u>
	(682,607)	(477,548)	(3,285,924)	(1,239,355)
Other Operating Expense:				
Decrease (increase) in estimated fair value of embedded derivative liabilities	(17,151)	(208,357)	(25,960)	(281,504)
Loss from Operations	(699,758)	(685,905)	(3,311,884)	(1,520,859)
Interest expense, net	104,477	124,870	380,193	369,364
Loss Before Income Taxes	(804,235)	(810,775)	(3,692,077)	(1,890,223)
Provision for income taxes	-	-	-	-
Net Loss	<u>\$ (804,235)</u>	<u>\$ (810,775)</u>	<u>\$ (3,692,077)</u>	<u>\$ (1,890,223)</u>
Basic net loss per share	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>
Basic weighted average shares outstanding	<u>314,543,467</u>	<u>282,741,138</u>	<u>299,894,284</u>	<u>280,245,143</u>
Diluted net loss per share	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>
Diluted weighted average shares outstanding	<u>314,543,467</u>	<u>282,741,138</u>	<u>299,894,284</u>	<u>280,245,143</u>

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

Coates International Ltd.
Condensed Consolidated Statements of Cash Flows
Unaudited

	For the Nine Months Ended September 30,	
	<u>2012</u>	<u>2011</u>
Net Cash Flows Used in Operating Activities	\$ (906,317)	\$ (1,013,211)
Net Cash Used in Investing Activities	<u>-</u>	<u>-</u>
Cash Flows Provided by (Used in) Financing Activities:		
Issuance of common stock and warrants	543,722	575,000
Issuance of convertible promissory notes	212,000	263,000
Issuance of promissory notes to related parties	194,255	278,594
Repayment of promissory notes to related party	(40,500)	(142,692)
Release from Interest reserve	-	60,000
Repayment of Mortgage Loan	(40,000)	(65,000)
Net Cash Provided by Financing Activities	<u>869,477</u>	<u>968,902</u>
Net Increase in Cash	(36,840)	(44,309)
Cash, beginning of period	52,955	53,360
Cash, end of period	<u>\$ 16,115</u>	<u>\$ 9,051</u>
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for interest	<u>\$ 81,976</u>	<u>\$ 107,097</u>
Supplemental Disclosure of Non-cash Financing Activities:		
Conversion of convertible promissory notes	\$ 297,960	\$ 245,960
Conversion of promissory notes to related parties	184,471	517,833
	<u>\$ 482,431</u>	<u>\$ 763,793</u>

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

Coates International, Ltd.
Notes to Consolidated Financial Statements
(All amounts rounded to thousands of dollars)
(Unaudited)

1. TIMELINESS OF FILING AND BASIS OF PRESENTATION

This quarterly report was initially required to be filed by November 14, 2012. However, the Securities and Exchange Commission issued Release No. 68224 under the Securities Exchange Act of 1934 which was intended to provide relief to public companies affected by the super storm known as Hurricane Sandy. This release extended the date for timely filing of this quarterly report to November 21, 2012 for companies that experienced disruption to their business from this storm. Therefore, this quarterly report has been filed on a timely basis. A total disruption to the Company's business and operations resulted from the storm which made landfall on October 30, 2012 in Monmouth County, New Jersey where the Company's headquarters are located. This included complete loss of electrical power and communications systems, among other things for almost eight consecutive days. The Company's employees also experienced a complete loss of electrical power and communications systems. Although the Company experienced this extended business interruption, its headquarters facility did not sustain any damage.

The accompanying unaudited consolidated financial statements of Coates International, Ltd. and its wholly-owned subsidiary (the "Company") have been prepared in accordance with accounting principles generally accepted for interim financial information and rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, they do not include all of the information and notes required by generally accepted accounting principles in the United States ("GAAP") for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for the nine months ended September 30, 2012 and 2011 are not necessarily indicative of the results that may be expected for any other interim period or for the full year. The unaudited consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2011 and quarterly reports on Form 10-Q for the quarters ended June 30 and March 31, 2012.

The Company incurred a net loss for the nine months ended September 30, 2012 of (\$3,692,000), and has incurred substantial net losses since inception while engaging primarily in research and development. As of September 30, 2012, the Company had an accumulated deficit of (\$30,389,000) and had negative working capital of (\$3,796,000). 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 in 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.

The Company has been actively undertaking efforts to secure new sources of working capital. During the nine months ended September 30, 2012, the Company raised net new working capital of \$935,000 consisting of proceeds of \$259,000 from the sale of common stock to Dutchess Opportunity Fund II, LP, consideration received from the sale of common stock and common stock warrants to the son of a director amounting to \$300,000, proceeds from issuance of convertible promissory notes amounting to \$212,000, proceeds from issuance of promissory notes to related parties, net of repayments of \$154,000 and consideration received from sale of common stock to one of our directors amounting to \$10,000. 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 consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The doubt about the Company's ability to continue to operate as a going concern has existed for a number of years. Management has been successful in raising sufficient new working capital throughout that time to enable the Company to continue as a going concern and, although management cannot provide assurances that it can be successful, management believes that it can continue to do so in the future. Management has instituted a cost control program intended to cut variable costs to only those expenses that are necessary to carry out its activities related to research and development and manufacturing natural gas-fueled industrial electric power Coates Spherical Rotary Valve ("CSRV") Gen Sets, entering the production phase of operations, developing additional commercially feasible applications of the CSRV system technology, seeking additional sources of working capital and covering the general and administrative expenses in support of such activities.

2. ACCOUNTING POLICIES

Principles of Consolidation

For the nine months ended September 30, 2012, the financial statements of the Company were consolidated with the accounts of Coates Oklahoma Engine Manufacturing, Ltd., a wholly owned subsidiary which was formed in 2011. All significant intercompany transactions and accounts were eliminated in consolidation.

Net Loss per Share

Basic net income (loss) per share is based on the weighted average number of common shares outstanding without consideration of potentially dilutive shares of common stock. Diluted net income (loss) 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 consolidated financial statements in conformity with GAAP for interim financial information and rules and regulations of the SEC requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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 a value for the Series A Preferred Stock issued and certain limited anti-dilution rights granted to George J. Coates, determining the amount of discount on convertible promissory notes, measuring the estimated fair value of embedded derivative liabilities related to convertible promissory notes outstanding, assigning useful lives to property, plant and equipment, determining an appropriate amount to reserve for obsolete and slow moving inventory, determining the amount of the allowance for deferred tax assets, assigning expected lives to, and estimating the rate of forfeitures of, stock options granted and selecting a trading volatility factor for the Company's common stock in order to estimate the fair value of stock options on the date of grant.

3. CONCENTRATIONS OF CREDIT AND BUSINESS RISK

At September 30, 2012, the Company maintained cash balances with one financial institution. The current balances in the accounts at this institution are fully insured by the Federal Deposit Insurance Corporation.

The Company's operations are devoted to the development, application and marketing of the CSRV system technology which was invented by George J. Coates, the Company's founder and his son Gregory Coates. George J. Coates is the Chairman, Chief Executive Officer, President and controlling stockholder of the Company. 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 system technology. Since the 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.

The Company is highly dependent on Almont Energy, Inc. (“Almont”) for cash flows, revenues and profits from a research and development agreement and exclusive sublicensing agreements covering sale and distribution of natural gas fueled, industrial electric power CSRV engine generators (“Gen Sets”) within the territories of Canada and the United States. As discussed in more detail in Note 5, at September 30, 2012, Almont owed the Company approximately \$5.8 million dollars due under the research and development, sublicensing and escrow agreements. Payment of this balance is dependent on Almont’s success in securing working capital financing and/or raising new equity capital. Almont has been unable to make substantial payments towards this balance due. Almont did not make any payments during the nine months ended September 30, 2012 and made a payment of \$150,000 during the nine months ended September, 2011.

4. LICENSING AGREEMENT AND DEFERRED LICENSING COSTS

The Company holds a manufacturing, use, lease and sale license from George J. Coates and Gregory Coates for the CSRV system technology in the territory defined as the Western Hemisphere (the “License Agreement”). Under the License Agreement, George J. Coates and Gregory 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 system technology (the “CSRV Engine”) and that is currently owned or controlled by them (the “CSRV Intellectual Property”), plus any CSRV 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 Coates.

Under the License Agreement, George J. Coates and Gregory Coates agreed that they will not grant any licenses to any other party with respect to the CSRV Intellectual Property.

At September 30, 2012, deferred licensing costs, comprised of expenditures for patent costs incurred pursuant to the CSRV licensing agreement, net of accumulated amortization, amounted to \$56,000. Amortization expense for the three months ended September 30, 2012 and 2011 amounted to \$1,000 and \$1,000, respectively. Amortization expense for the nine months ended September 30, 2012 and 2011 amounted to \$3,000 and \$3,000, 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 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 had 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. Almont made a \$150,000 nonrefundable payment to the Company to pay down the Release Payment during the nine months ended September 30, 2011. At September 30, 2012, the remaining balance of the Release Payment was \$5,847,000. It is not likely that Almont will be able to make additional payments of the Release Payment unless it can raise new working capital and/or experience positive cash flow from its operations. This has delayed the Company’s plans to commence production of the Gen Sets.

In connection with the assignment of the Canadian License and the rights to the US License, Almont has also assumed all of the obligations set forth in the Escrow Agreement, with the following modifications:

- At the time of the assignment, the remaining unpaid balance of the Release Payment was approximately \$6 million. Provided that Almont remits this entire unpaid balance to the Company on or before the Release Payment Date, the US License will be released from escrow and granted to Almont. The Release Payment Date, as defined in the Escrow Agreement lapsed in March 2012. The Company agreed to extend the Release Payment Date under the Escrow Agreement until March 2014 to compensate for the delay caused by the late delivery of Gen Sets. Almont is required to remit to the Company 60% of all monies it raises from future equity or debt transactions, exclusive of proceeds from equipment purchase financing transactions, until the Release Payment is paid in full.
- Almont also became obligated to pay the \$49 million portion of the US License Fee to the Company. Payment shall be made quarterly in an amount equal to 5% of Almont’s quarterly net profits. In addition, Almont is required to remit a portion of the proceeds it receives from equity or debt transactions, exclusive of equipment financing transactions to the Company until the entire the US License fee is paid in full. In any event, the \$49 million portion of the licensing fee is required to be paid on or before February 19, 2014. In July, the Company agreed to extend this date by two years to 2016 to compensate for the late delivery of Gen Sets.

Payment of the Release Payment is dependent on the Company starting up production to fulfill Almont’s orders. To the extent that Almont is not successful or experiences delays in remitting the balance of the Release Payment, the Company’s cash flow, results of operations and financial condition will be adversely affected.

The Canadian License

The Canadian License exclusively sublicenses within Canada the use of the CSRV system technology for industrial engines designed to generate electrical power. Additional provisions of the Canadian License agreement are as follows:

- Sublicensee shall have the exclusive right to use, lease and sell electric power generators designed with the CSRV 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. The Company has temporarily waived this provision due to the delay in delivery of Gen Sets. In the event Sublicensee fails to purchase the minimum 120 CSRV generator engines during any year, Sublicensee will automatically lose its exclusivity. In such a case, Sublicensee would retain non-exclusive rights to continue to use and sell the CSRV generator engines in the territory of Canada. Until otherwise agreed between the parties, the price per generator shall be \$159,000. The Company has agreed to adjust the price per generator accordingly to consider the savings, if any, realized from economies of scale inherent in high volume production of the CSRV units.
- Sublicensee is required to pay a royalty to the Company 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 license agreement related to the CSRV system technology will remain with the Company.

The US License

The US License will, upon Almont satisfying the Release Payment, grant to Almont the right to use, sell and lease within the defined territory, Licensed Products manufactured by the Company which are designed to generate electrical power. 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 the Company 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 any Licensed Products by Sublicensee is prohibited. Sublicensee is required to procure all internal combustion engines incorporating the CSRV Valve System from the Company or its designee. The license granted to Sublicensee is exclusive within the Territory, provided that Sublicensee satisfies the minimum annual purchase commitment of 120 internal combustion engines incorporating the CSRV system technology, the Coates Engines and all component parts. The Company has temporarily waived this provision due to the delay in delivery of Gen Sets. The agreement also grants Sublicensee a right of first refusal in the event that the Company negotiates an offer with another third party for a worldwide license to use the Licensed Products for the generation of electrical power.

The business plan of Almont, which is highly dependent on its ability to raise sufficient additional working capital, assumes the purchase of a substantial number of CSRV units over the next 5 years. Almont's purchase of CSRV Units from the Company will be made by way of standard purchase orders, issued based on market and customer demand. Almont has projected that annual demand for Gen Sets could be as much as 11,000 units if the Company can achieve full scale production. We are unable to confirm these orders until we have sufficient working capital in place to manufacture generators on a large scale. Almont plans to finance its purchases from cash flow and by way of project and/or equipment financing, proceeds from issuance of equity or corporate debt instruments and conventional bank financing.

6. NON-BINDING PRELIMINARY LETTER OF INTENT TO MERGE WITH S.W.T. IN CHINA

In May 2011, the Company entered into a non-binding letter of intent with S.W.T., an established heavy equipment manufacturer in China and The Coates Trust. The letter expressed the mutual intent of the parties to exchange shares of common stock between the Company and S.W.T., a cash payment to the shareholders of S.W.T. and the issuance of shares of the Company's common stock to The Coates Trust in consideration of a CSRV technology license for China. The transaction would be subject to required governmental approvals and a number of other prerequisite conditions. In September 2011, the Company determined that the risk of proceeding with this merger transaction as contemplated at that time was greater than anticipated. Accordingly, the Company will either continue to explore the possibility of restructuring the merger transaction or taking a simpler approach that would enable it to have access to the manufacturing capabilities of S.W.T. while affording both companies the opportunity to benefit from CSRV system technology related manufacturing activities. At this time, further discussions with S.W.T. are on hold until the management of S.W.T. can observe the CSRV system technology performing in the Canadian oil and gas fields.

7. COOPERATION AGREEMENT WITH TONGJI UNIVERSITY OF CHINA

In June 2010, the Company and the Coates Trust (collectively "Coates") entered into a cooperation agreement with Tongji University of China (the "University") for the purpose of enabling the University to undertake an evaluation and testing of the CSRV engine technology. The results of the evaluation and testing will be used to determine if, and to what extent, the engine technology could be applied in the manufacture and distribution of products in China. Coates is required to deliver to the University a 1600cc, 4-cylinder CSRV engine and a 1600cc, 4-cylinder poppet valve engine to facilitate comparison. The University is responsible for obtaining any required regulatory approvals in connection with the evaluation and testing activities. The costs and expenses of testing and evaluation of the engine shall be the responsibility of the University. Coates is required to provide technical assistance, as needed, to optimize the success of the evaluation and testing.

The University is to promptly furnish Coates with a copy of its findings. Provided the results of the evaluation and testing of the CSRV engines are deemed satisfactory, Coates has agreed that it will sublicense the CSRV technology to Chinese engine manufacturers. The parties also entered into a confidentiality and non-disclosure agreement which provides for protection of the CSRV technical information and patents. The Coates Trust has expressed its intention to license the CSRV system technology rights to the Company for the territory to be defined in connection with any such licenses granted to Chinese manufacturers. To date, the terms of any such license have not been determined. At this time, the parties are not actively working on this cooperation agreement, but may agree to do so at some point in the future.

8. MANUFACTURING SUBSIDIARIES

The Company formed a wholly-owned manufacturing subsidiary in 2011 with the intent to establish manufacturing operations within the State of Oklahoma. This subsidiary has been inactive as discussions with the state for a package of business and tax incentives are on hold. The Company formed another manufacturing subsidiary in 2012 with the intent to establish manufacturing operations within another state. The Company owns approximately 66% of this subsidiary. It has been inactive pending the outcome of discussions with this state for a package of business and tax incentives intended to induce the Company to establish its manufacturing operations within this state. The Company is precluded from disclosing the name of this state, until discussions are concluded, by a confidentiality agreement.

9. LICENSE DEPOSITS

License deposits, which are non-refundable, primarily relate to a \$300,000 sublicense deposit received in prior years from WWE as a down payment on the Canadian License. The Company is recognizing the license deposit of \$300,000 on the Canadian Licensee as revenue on a straight-line basis over the approximately 16-year remaining life of the last CSRV technology patent in force at that date. Sublicensing fee revenue for the three months ended September 30, 2012 and 2011, amounted to \$5,000 and \$5,000, respectively. Sublicensing fee revenue for the nine months ended September 30, 2012 and 2011, amounted to \$14,000 and \$10,000, respectively.

10. INVENTORY

Inventory was comprised of the following:

	<u>September 30, 2012</u>	<u>December 31, 2011</u>
Raw materials	\$ 444,000	\$ 473,000
Work-in-process	54,000	65,000
Finished goods	-	-
Reserve for obsolescence	(151,000)	(151,000)
Total	<u>\$ 347,000</u>	<u>\$ 387,000</u>

11. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment were comprised of the following:

	September 30, 2012	December 31, 2011
Land	\$ 1,235,000	\$ 1,235,000
Building	964,000	964,000
Building improvements	83,000	83,000
Machinery and equipment	658,000	658,000
Furniture and fixtures	39,000	39,000
	<u>2,979,000</u>	<u>2,979,000</u>
Less: Accumulated depreciation	(721,000)	(676,000)
Total	<u>\$ 2,258,000</u>	<u>\$ 2,303,000</u>

12. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consisted of the following:

	September 30, 2012	December 31, 2011
Legal and professional fees	\$ 1,248,000	\$ 1,004,000
Accrued compensation and benefits	164,000	156,000
General and administrative expenses	118,000	111,000
Patent Maintenance	22,000	-
Accrued interest expense	25,000	88,000
Total	<u>\$ 1,577,000</u>	<u>\$ 1,359,000</u>

13. 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. In June 2012, the Company negotiated a further extension of the mortgage loan from July 2012 to July 2013 on the same terms and conditions. Interest expense for the three months ended September 30, 2012 and 2011 on this mortgage amounted to \$31,000 and \$32,000, respectively. Interest expense for the nine months ended September 30, 2012 and 2011 on this mortgage amounted to \$92,000 and \$95,000, respectively. The loan requires monthly payments of interest, plus \$5,000 which is being applied to the principal balance. The remaining outstanding principal balance at September 30, 2012, was \$1,590,000.

The Company is required to make monthly payments totaling \$16,000 over the mortgage loan extension period comprising the mortgage extension fee. 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. Up to \$500,000 of the principal balance of the mortgage loan may be prepaid each year without penalty. A prepayment penalty of 2% of the outstanding loan amount would be imposed if the loan is repaid in full at or before maturity unless such prepayment funds are obtained from a permanent mortgage loan with the lender.

14. PROMISSORY NOTES TO RELATED PARTIES

The Company has received proceeds from promissory notes issued from time to time to George J. Coates and has also made partial repayments of these promissory notes. At September 30, 2012, the outstanding balance of these notes amounted to \$365,000. These notes are due on demand and bear interest at the rate of 17% per annum, compounded monthly. During the nine months ended September 30, 2012 and 2011, \$118,000 and \$267,000, respectively of promissory notes were issued and \$31,000 and \$125,000, respectively, of these promissory notes were repaid. In June 2012, by mutual agreement accrued interest on these notes amounting to \$54,000 was converted into 907,340 shares of common stock at a conversion price of \$0.06 per share.

In 2011, the Company issued promissory notes to two of its directors with an aggregate principal balance of \$170,000. In June 2012, by mutual agreement, \$130,000 principal amount of these promissory notes were converted into 2,166,667 shares of common stock at a conversion price of \$0.06 per share. These notes are due on demand and bear interest at the rate of 17% per annum, compounded monthly.

During the nine months ended September 30, 2012, the Company received cash proceeds of \$76,000 from Bernadette Coates, the spouse of George J. Coates and issued promissory notes which are due on demand and bear interest at the rate of 17% per annum, compounded monthly. In June 2012, \$10,000 principal amount of these notes was repaid.

For the three months ended September 30, 2012 and 2011, interest expense on all of these promissory notes amounted to \$20,000 and \$7,000, respectively. For the nine months ended September 30, 2012 and 2011, interest expense on all of these promissory notes amounted to \$53,000 and \$36,000, respectively. At September 30, 2012, unpaid accrued interest on these promissory notes amounting to \$23,000 is included in accounts payable and accrued liabilities in the accompanying consolidated balance sheet.

15. CONVERTIBLE PROMISSORY NOTES AND EMBEDDED DERIVATIVE LIABILITIES

The Company entered into a series of securities purchase agreements (the "Purchase Agreements") in 2011 and 2012 with an investor and issued convertible promissory notes, as follows:

Issued	Principal Amount	Nominal Interest Rate	Maturity	Balance, September 30, 2012
February 2011	\$ 32,500	8.00%	November 2011	\$ -
May 2011	100,000	8.00%	February 2012	-
July 2011	78,500	8.00%	April 2012	-
September 2011	52,000	8.00%	June 2012	-
October 2011	52,000	8.00%	July 2012	-
November 2011	52,000	8.00%	August 2012	-
January 2012	52,000	8.00%	October 2012	-
April 2012	42,500	8.00%	January 2013	42,500
June 2012	42,500	8.00%	March 2013	42,500
August 2012	42,500	8.00%	May 2013	42,500
September 2012	32,500	8.00%	June 2013	32,500
	<u>\$ 579,000</u>			<u>\$ 160,000</u>

The Notes may be converted into unregistered shares of the Company's common stock, par value \$0.0001 per share (the "Common Stock"), at the Conversion Price, as defined below, in whole, or in part, at any time beginning 180 days after the date of issuance of the Notes, at the option of the holder. The Conversion Price shall be equal to 61% multiplied by the Variable Conversion Rate which is equal to the average of the three (3) lowest closing bid prices of the Common Stock during the ten (10) trading day period prior to the date of conversion. The Notes also contain a prepayment option whereby the Company may make a payment to the holder equal to between 130% and 150% of the then outstanding unpaid principal, interest and any other amounts that might be due for penalties or any event of a default under the Notes during the 179-day period following the date of issuance of the Notes, upon three (3) trading days' prior written notice to the holder.

The 61% discounted Conversion Price establishes a beneficial conversion feature (“BCF”) which is required to be valued and accreted to interest expense over the six-month period until the conversion of the convertible promissory notes into common stock is permitted. The Company is also required to record additional unamortized discount to recognize the estimated value of the derivative liabilities arising from the convertible promissory notes. Accordingly, the Company recorded a total initial amount of unamortized discount on the Convertible Notes outstanding at September 30, 2012, of \$143,000. For the three months ended September 30, 2012 and 2011, the amount of interest expense resulting from accretion of the unamortized discount on the convertible promissory notes amounted to \$47,000 and \$78,000, respectively. For the nine months ended September 30, 2012 and 2011, the amount of interest expense resulting from accretion of the unamortized discount on the convertible promissory notes amounted to \$213,000 and \$224,000, respectively.

The total unamortized discount represented by the value of the BCF is being accreted over the six-month period until the conversion of the convertible promissory notes into common stock is permitted. This resulted in an overall effective interest rate of 147%, 147%, 147%, 123%, 147%, 92%, 130%, 125%, 142%, 142% and 122% on the \$32,500, \$100,000, \$78,500, \$52,000, \$52,000, \$52,000, \$52,000, \$42,500, \$42,500 and \$32,500 convertible notes, respectively. The remaining unamortized balance of this discount, which amounted to \$104,000 at September 30, 2012, has been netted against the face amount of the convertible promissory notes resulting in a net carrying amount of \$56,000. This net amount is presented in the accompanying consolidated balance sheet at September 30, 2012.

In accordance with GAAP, the conversion features associated with the convertible promissory notes represent derivatives. The Company initially recorded the estimated value of the embedded derivative liabilities related to the convertible promissory notes outstanding at September 30, 2012 of \$17,000. The estimated fair value of the embedded derivative liability is required to be remeasured at each balance sheet date. The estimated fair value of the embedded derivative liabilities, which were measured at their aggregate estimated fair value, based on Level 2 inputs, amounted to \$281,000, at September 30, 2012. The increase in the estimated fair value of the embedded derivative liabilities amounted to (\$17,000) and (\$208,000) for the three months ended September 30, 2012 and 2011, respectively. The increase in the estimated fair value of the embedded derivative liabilities amounted to (\$26,000) and (\$282,000) for the nine ended September 30, 2012 and 2011, respectively. These amounts are included in the accompanying consolidated statements of operations as increase in estimated fair value of embedded derivative liabilities.

The embedded derivative liabilities arise because, based on historical trading patterns of the Company’s stock, the formula for determining the Conversion Rate is expected to result in a lower 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 value of the derivative liabilities have been calculated based on a Black-Scholes option pricing model.

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. 10% CONVERTIBLE NOTE TO RELATED PARTY

The 10% Convertible Note, which is held by one of the Company’s directors, is convertible at the option of the holder, into shares of the Company’s common stock at an initial conversion rate that is determined by dividing the principal amount of the note being converted by \$0.45. This convertible note is payable on demand. Interest shall accrue at the rate of 10% per annum and shall be payable at the time of repayment of principal. All interest shall be forfeited upon conversion, in which case the holder would be entitled to dividends declared, if any, on the Company’s common stock during the time the convertible note was outstanding. The Company has reserved 22,222 shares of its common stock for conversion of this note.

17. CONTRACTUAL OBLIGATIONS

The following table summarizes the Company's contractual obligations at September 30, 2012:

	<u>Total</u>	<u>Due Within</u>	
		<u>2012</u>	<u>2013</u>
Mortgage loan payable	\$ 1,590,000	\$ 15,000	\$ 1,575,000
Promissory notes to related parties	471,000	471,000	-
Deferred compensation	151,000	151,000	-
Convertible promissory notes	160,000	-	160,000
10% promissory note	10,000	10,000	-
Total	<u>\$ 2,382,000</u>	<u>\$ 647,000</u>	<u>\$ 1,735,000</u>

18. CAPITAL STOCK

Common Stock and Anti-dilution Rights

The Company's common stock is traded on the Over the Counter Bulletin Board ("OTCBB") market system and Pink Sheets under the ticker symbol COTE. The Company is authorized to issue up to 1,000,000,000 shares of common stock, par value, \$0.0001 per share (the "Common Stock").

During the nine months ended September 30, 2012 and 2011, the Company sold a total of 2,161,706 and -0- registered shares of its common stock, respectively, under an equity line of credit with Dutchess Opportunity Fund II, LP ("Dutchess") and received proceeds of \$259,000 and \$-0-, respectively, which was used for working capital purposes. There were no offering costs related to the sale of these shares. In April 2012, the Company issued 500,000 shares of its common stock to Dutchess to be used to settle put options to be issued in the future under the equity line of credit. At September 30, 2012, 94,971 of these shares of common stock had not been used to settle put options. Any of these shares not actually sold under the equity line of credit are required to be returned to the Company at any time, upon request.

During the nine months ended September 30, 2012, the Company sold a total of 4,028,587 restricted shares of its common stock and 416,667 warrants to purchase one share of its common stock at an exercise price of \$0.12 per share, 666,666 warrants to purchase one share of its common stock at an exercise price of \$0.09 per share, 571,529 warrants to purchase one share of its common stock at an exercise price of \$0.07 per share, 4,269,838 warrants to purchase one share of its common stock at an exercise price of \$0.625 per share, 1,500,000 warrants to purchase one share of its common stock at an exercise price of \$0.6 per share and 1,090,910 warrants to purchase one share of its common stock at an exercise price of \$0.55 per share in consideration for \$275,000 received from the son of a director.

During the nine months ended September, 2012, the Company sold 190,185 restricted shares of its common stock valued at \$25,000 in consideration for 185,185 tradable shares of its common stock received from this son of a director, which were used to pay for contractual services in lieu of a cash payment.

During the nine months ended September 30, 2011, the Company sold a total of 1,930,036 restricted shares of its common stock, 142,857 warrants to purchase one share of its common stock at an exercise price of \$0.35 per share, 153,846 warrants to purchase one share of its common stock at an exercise price of \$0.325 per share, 833,333 warrants to purchase one share of its common stock at an exercise price of \$0.27 per share and 800,000 warrants to purchase one share of its common stock at an exercise price of \$0.25 per share in consideration for \$525,000 received from this son of a director. These transactions were private sales of unregistered, restricted securities pursuant to stock purchase agreements.

During the nine months ended September 30, 2012, the Company sold 166,666 restricted shares of its common stock in consideration for \$10,000 to one of its directors. During the nine months ended September 30, 2011, the Company sold 200,000 restricted shares of its common stock in consideration for \$50,000 to one of its directors. These transactions were private sales of unregistered, restricted securities pursuant to stock purchase agreements.

During the nine months ended September 30, 2012, by mutual agreement, promissory notes in the principal amount of \$130,000 held by two directors were converted into 2,166,667 restricted shares of common stock representing a conversion price per share of \$0.06.

During the nine months ended September 30, 2012, by mutual agreement accrued interest on promissory notes held by George J. Coates, amounting to \$54,000 was converted into 907,340 restricted shares of common stock representing a conversion price per share of \$0.06.

During the nine months ended September 30, 2012, the Company issued 620,000 and 1,340,000 restricted shares of common stock to George J. Coates and two directors, respectively, in satisfaction of deferred compensation that was charged to expense in fiscal year 2011. Under the terms of this deferred compensation arrangement, the Company is obligated to pay the personal income taxes of the recipient of these shares of stock.

During the nine months ended September 30, 2012, a total of \$297,000 of convertible promissory notes including accrued interest thereon were converted by the holder into 5,630,928 restricted shares of the Company's common stock. During the nine months ended September 30, 2011, a total of \$246,000 of convertible promissory notes including accrued interest thereon was converted by the holder into 1,899,948 restricted shares of the Company's common stock.

A new anti-dilution program became effective as of January 1, 2012, pursuant to which George J. Coates, majority shareholder, is to be issued one restricted share of common stock of the Company for each new share issued to any person or entity that is not a member of the Coates family. For the nine months ended September 30, 2012, pursuant to this anti-dilution arrangement, the Company issued 15,649,239 restricted shares of its common stock to George J. Coates and recorded stock-based compensation expense aggregating \$1,456,000.

There were no other sales of, or conversions into, common stock during the nine months ended September 30, 2012.

At September 30, 2012, Company had reserved 48,783,914 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 new 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 shall have authority 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.

The Board has designated 100,000 shares of Preferred Stock as Series A Preferred Stock, \$0.001 par value per share. Each share of Series A Preferred Stock entitles the holder of record to the right to vote 10,000 shares of common stock with respect to all matters that are submitted to a vote of shareholders. The Series A Preferred Stock does not provide the holder any rights to share in dividends or any distribution of assets to any other shareholders of any other class of the Company's securities in a liquidation or for any other purpose.

No new shares of Series A Preferred Stock were issued during the nine months ended September 30, 2012. During the nine months ended September 30, 2011, 4,986 shares of Series A Preferred Stock were issued to George J. Coates pursuant to an anti-dilution agreement then in effect and a compensatory award of 50,000 shares of Series A Preferred Stock were granted George J. Coates resulting in the right to 549,860,000 aggregate additional votes. Stock-based compensation amounting to \$143,000 was charged to expense for these transactions. This anti-dilution agreement was terminated as of December 31, 2011.

Each issuance of shares of Series A Preferred Stock 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.

19. INVESTMENT AGREEMENTS WITH DUTCHESS OPPORTUNITY FUND II, LP

In June 2011, the Company entered into an investment agreement (the "Investment Agreement") with Dutchess Opportunity Fund II, LP, a Delaware limited partnership ("Dutchess"). Pursuant to the terms of the Investment Agreement, Dutchess committed to purchase, in a series of purchase transactions ("Puts") up to Twenty Million (\$20,000,000) Dollars of the Company's common stock over a period of up to thirty-six (36) months.

The amount that the Company is entitled to request with each Put delivered to Dutchess is equal to, at its option, either (i) two hundred percent (200%) of the average daily volume (U.S. market only) of its common stock for the three (3) Trading Days prior to the applicable Put Notice Date, multiplied by the average of the three (3) daily closing prices immediately preceding the Put Date or (ii) five hundred thousand dollars (\$500,000). The purchase price to be paid by Dutchess for the shares of common stock covered by each Put will be equal to ninety-four percent (94%) of the lowest daily volume weighted average prices of the common stock during the period beginning on the Put Notice Date and ending on and including the date that is five (5) trading days after such Put Notice Date (the "Pricing Period"). "Put Notice Date" is the trading day immediately following the day on which Dutchess receives a Put Notice from the Company.

In connection with the Investment Agreement, the Company also entered into a registration rights agreement (the "Registration Rights Agreement") with Dutchess. Pursuant to the Registration Rights Agreement, the Company filed a registration statement with the Securities and Exchange Commission ("SEC") covering 17,500,000 shares of the common stock underlying the Investment Agreement which became effective in August 2011. In addition, during the term of the Registration Rights Agreement, the Company is obligated to maintain the effectiveness of such registration statement.

During the nine months ended September 30, 2012 and 2011, the Company sold 2,161,706 and \$-0- registered shares of its common stock, respectively, under this equity line of credit with Dutchess and received proceeds of \$259,000 and \$-0-, respectively. There were no offering costs related to the sale of these shares.

20. UNEARNED REVENUE

The Company has remaining non-refundable deposits amounting to \$19,000 from Almont in connection with the future shipment of natural gas fueled electric power CSRV engine generators and a \$10,000 refundable deposit related to the future potential issuance of a license for the CSRV technology. This amount is included in unearned revenue in the accompanying consolidated balance sheets at September 30, 2012 and 2011.

21. LOSS PER SHARE

At September 30, 2012, the Company had 28,367,536 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	5,607,000	0.0600	-	5,607,000
Common stock options	1,800,000	0.2400	1,800,000	-
Common stock options	2,000,000	0.2500	2,000,000	-
Common stock options	50,000	0.3900	50,000	-
Common stock options	360,000	0.4000	360,000	-
Common stock options	100,000	0.4300	100,000	-
Common stock options	1,750,000	0.4400	1,750,000	-
Common stock options	30,000	1.0000	30,000	-
Common stock warrants	1,090,910	0.0550	N/A	N/A
Common stock warrants	1,500,000	0.0600	N/A	N/A
Common stock warrants	4,269,838	0.0625	N/A	N/A
Common stock warrants	571,529	0.0700	N/A	N/A
Common stock warrants	666,666	0.0900	N/A	N/A
Common stock warrants	416,667	0.1200	N/A	N/A
Common stock warrants	1,200,000	0.2500	N/A	N/A
Common stock warrants	833,333	0.2700	N/A	N/A
Common stock warrants	333,333	0.3000	N/A	N/A
Common stock warrants	153,846	0.3250	N/A	N/A
Common stock warrants	1,028,570	0.3500	N/A	N/A
\$10,000, 10% Convertible promissory note	22,222	0.4500	N/A	N/A
8% Convertible promissory notes	4,583,622	(1)	N/A	N/A
Total	28,367,536			

(1) The principal amount of convertible promissory notes outstanding, none of which were eligible for conversion at September 30, 2012, was \$160,000. The conversion rate is variable as it is equal to the average of the three lowest closing bid prices during the ten trading days prior to the date of conversion. 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 three lowest closing bid prices during the ten trading days prior to September 30, 2012.

At September 30, 2011, the Company had 11,882,337 shares of common stock potentially issuable upon assumed conversion.

For the nine months ended September 30, 2012 and 2011, and for the three months ended September 30, 2012 and 2011, 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.

22. STOCK OPTIONS

The Company's 2006 Stock Option and Incentive Plan (the "Stock Plan") was adopted by the Board in October 2006. In September 2007, the Stock Plan, by consent of George J. Coates, majority shareholder, was adopted by the Company's 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 ("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 employees of the Company. A total of 25,000,000 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 to any employee in any year under the Stock Plan shall not exceed 25% of the 25,000,000 total number of shares of common stock permitted to be granted under the Stock Plan. At September 30, 2012, there remained 11,453,000 shares of common stock eligible for future stock option and award grants under the Stock Plan.

The Stock Plan is administered by the Board and the Compensation Committee. Subject to the provisions of the Stock Plan, 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 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 nine months ended September 30, 2012, stock options to purchase 3,792,000 shares of the Company's common stock at an exercise price of \$0.06 per share were granted to two of the Company's directors and stock options to purchase 1,815,000 shares of the Company's common stock at an exercise price of \$0.06 per share were granted to George J. Coates. All of these stock options will vest in June 2013 and expire in 2027. The total estimated fair market value of stock options granted during the nine months ended September 30, 2012 was \$358,000. During the nine months ended September 30, 2011, stock options to purchase 1,800,000 shares of the Company's common stock at an exercise price of \$0.24 per share and stock options to purchase 2,000,000 shares of the Company's common stock at an exercise price of \$0.25 per share were granted to three of the Company's directors, including 1,800,000 stock options granted to George J. Coates. These stock options vested in 2012 and expire in 2026. The total estimated fair market value of stock options granted during the nine months ended September 30, 2011 was \$917,000.

During the nine months ended September 30, 2012, 1,800,000 stock options with an exercise price of \$0.24 per share and 2,000,000 stock options with an exercise price of \$0.25 per share became vested. During the nine months ended September 30, 2011, no stock options became vested. The estimated fair value of 5,607,000 nonvested stock options at September 30, 2012 was \$358,000. Total compensation cost related to nonvested stock options at September 30, 2012 that had not been recognized was \$269,000. This non-cash compensation expense will be recognized in the future over a remaining weighted average period of approximately nine months.

For the three months ended September 30, 2012 and 2011, the Company recorded non-cash stock-based compensation expense related to employee stock options amounting to \$163,000 and \$131,000, respectively. For the three months ended September 30, 2012 and 2011, \$41,000 and \$48,000, respectively, of this amount is included in research and development expenses and \$122,000 and \$83,000, respectively, of this amount is included in general and administrative expenses in the accompanying consolidated statements of operations.

For the nine months ended September 30, 2012 and 2011, the Company recorded non-cash stock-based compensation expense related to employee stock options amounting to \$624,000 and \$212,000, respectively. For the nine months ended September 30, 2012 and 2011, \$217,000 and \$54,000, respectively, of this amount is included in research and development expenses, \$0- and \$3,000, respectively, of this amount was allocated to work in process inventory and \$407,000 and \$155,000, respectively, of this amount is included in general and administrative expenses in the accompanying consolidated statements of operations.

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

	<u>Exercise Price Per Share</u>	<u>Number Outstanding</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Number Exercisable</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Fair Value Per Stock Option at Date of Grant</u>
Balance, 1/1/12	\$ 0.25 -1.00	6,090,000	12	2,290,000	\$ 0.32	\$ 0.28
Stock options granted	0.06	5,607,000	15	-	0.06	0.06
Vested	0.24	-	14	1,800,000	0.24	0.24
Vested	0.25	-	14	2,000,000	0.25	0.24
Balance, 9/30/12	\$ 0.06 -1.00	<u>11,697,000</u>	14	<u>6,090,000</u>	\$ 0.19	\$ 0.18

No stock options were exercised, forfeited or expired during the nine months ended September 30, 2012.

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	139-180%
● 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 initially obtained the volatility factor of other publicly traded engine manufacturers that were also in the research and development stage. Subsequently, once sufficient trading history became available, the volatility factor was calculated based on the historical daily closing prices of the Company's common stock on the OTCBB.
- 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 black out 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 same methodology and assumptions were utilized in estimating the fair value of non-employee stock options granted to the Company's general corporate counsel, as discussed above.

23. 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 \$595,000 and \$353,000 for the three months ended September 30, 2012 and 2011, respectively. These amounts were fully offset by a corresponding decrease in the tax valuation allowance resulting in no net change in deferred tax assets, respectively, during these periods.

Deferred tax assets increased by \$1,212,000 and decreased by (\$97,000) for the nine months ended September 30, 2012 and 2011, respectively. These amounts were fully offset by a corresponding decrease (increase) in the tax valuation allowance resulting in no net change in deferred tax assets, respectively, during these periods.

No liability for unrecognized tax benefits was required to be reported at September 30, 2012 and 2011. 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 tax years ended 2008 through 2011, 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 nine months ended September 30, 2012 and 2011, there were no penalties or interest related to the Company's income tax returns.

24. RELATED PARTY TRANSACTIONS

Compensation and Benefits Paid

The approximate amount of compensation and benefits paid to George J. Coates, Gregory Coates and Bernadette Coates is summarized as follows:

	<u>For the Three Months Ended September 30,</u>		<u>For the Nine Months Ended September 30,</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
George J. Coates	\$ 326,000	\$ 186,000	\$ 1,957,000	\$ 488,000
Gregory Coates	79,000	131,000	381,000	218,000
Bernadette Coates	19,000	21,000	56,000	60,000

Included in compensation paid to George J. Coates during the three months ended September 30, 2012 is \$189,000 of stock-based compensation expense representing the estimated fair value of 2,784,457 shares of common stock issued to George J. Coates pursuant to an anti-dilution agreement in effect and \$67,000 representing stock-based compensation expense for stock options. Included in compensation to George J. Coates during the three months ended September 30, 2011 is \$5,000 representing the estimated fair value of 2,106 shares of Series A Preferred Stock awarded pursuant to an anti-dilution agreement in effect. Also included is \$89,000 representing stock-based compensation expense for stock options.

Included in compensation paid to Gregory Coates for the three months ended September 30, 2012, is \$36,000 representing stock-based compensation expense for stock options. Included in compensation paid to Gregory Coates for the three months ended September 30, 2011, is \$72,000 representing stock-based compensation expense for stock options.

Included in compensation paid to George J. Coates during the nine months ended September 30, 2012 is \$1,456,000 of stock-based compensation expense representing the estimated fair value of 15,649,239 shares of common stock issued to George J. Coates pursuant to an anti-dilution agreement in effect and \$291,000 representing stock-based compensation expense for stock options. Included in compensation to George J. Coates during the nine months ended September 30, 2011 is \$143,000 representing the estimated fair value of 7,092 shares of Series A Preferred Stock awarded pursuant to an anti-dilution agreement in effect and a compensatory award of 50,000 shares of Series A Preferred Stock. Also included is \$118,000 representing stock-based compensation expense for stock options.

Included in compensation paid to Gregory Coates for the nine months ended September 30, 2012, is \$252,000 representing stock-based compensation expense for stock options. Included in compensation paid to Gregory Coates for the nine months ended September 30, 2011, is \$72,000 representing stock-based compensation expense for stock options.

Promissory Notes to Related Parties

During the nine months ended September 30, 2012 and 2011, \$118,000 and \$267,000, respectively of promissory notes due to George J. Coates were issued and \$31,000 and \$125,000, respectively, of promissory notes due to George J. Coates were repaid.

During the nine months ended September 30, 2012 and 2011, \$76,000 and \$12,000, respectively of promissory notes due to Bernadette Coates, spouse of George J. Coates were issued and \$10,000 and \$18,000, respectively, of promissory notes due to Bernadette Coates were repaid.

In June 2012, by mutual agreement, accrued interest on promissory notes due to George J. Coates amounting to \$54,000 was converted into 907,340 shares of common stock at a conversion price of \$0.06 per share.

In June 2012, by mutual agreement, \$130,000 principal amount of promissory notes due to two of the Company's directors were converted into 2,166,667 shares of common stock at a conversion price of \$0.06 per share.

For the three months ended September 30, 2012 and 2011, interest expense on promissory notes due to George J. Coates, Bernadette Coates, spouse of George J. Coates and two of the Company's directors aggregated \$20,000 and \$7,000, respectively.

For the nine months ended September 30, 2012 and 2011, interest expense on promissory notes due to George J. Coates, Bernadette Coates and two of the Company's directors aggregated \$53,000 and \$36,000, respectively.

Other

During the three months ended September 30, 2012 and 2011, Barry C. Kaye, Treasurer and Chief Financial Officer was paid compensation of \$11,000 and \$22,000, respectively.

During the nine months ended September 30, 2012 and 2011, Barry C. Kaye, Treasurer and Chief Financial Officer was paid compensation of \$46,000 and \$76,000, respectively.

During the nine months ended September 30, 2012, the Company sold a total of 4,028,587 restricted shares of its common stock and 416,667 warrants to purchase one share of its common stock at an exercise price of \$0.12 per share, 666,666 warrants to purchase one share of its common stock at an exercise price of \$0.09 per share, 571,529 warrants to purchase one share of its common stock at an exercise price of \$0.07 per share, 4,269,838 warrants to purchase one share of its common stock at an exercise price of \$0.625 per share, 1,500,000 warrants to purchase one share of its common stock at an exercise price of \$0.6 per share and 1,090,910 warrants to purchase one share of its common stock at an exercise price of \$0.55 per share in consideration for \$275,000 received from the son of a director. During the nine months ended September, 2012, the Company also sold 190,185 restricted shares of its common stock valued at \$25,000 in consideration for 185,185 tradable shares of its common stock received from this son of a director, which were used to pay for contractual services in lieu of a cash payment.

During the nine months ended September 30, 2011, the Company sold a total of 1,930,036 restricted shares of its common stock, 142,857 warrants to purchase one share of its common stock at an exercise price of \$0.35 per share, 153,846 warrants to purchase one share of its common stock at an exercise price of \$0.325 per share, 833,333 warrants to purchase one share of its common stock at an exercise price of \$0.27 per share and 800,000 warrants to purchase one share of its common stock at an exercise price of \$0.25 per share in consideration for \$525,000 received from this son of a director.

All of these transactions were private sales of unregistered, restricted securities pursuant to stock purchase agreements.

During the nine months ended September 30, 2012, the Company sold 166,666 restricted shares of its common stock in consideration for \$10,000 to one of its directors. During the nine months ended September 30, 2011, the Company sold 200,000 restricted shares of its common stock in consideration for \$50,000 to one of its directors. These transactions were private sales of unregistered, restricted securities pursuant to stock purchase agreements.

25. LITIGATION AND CONTINGENCIES

Mark D. Goldsmith, a former executive of the Company, filed a lawsuit in January 2008 in which he asserts that the Company is liable to him for breach of an employment contract that never became effective. In the opinion of management, Mr. Goldsmith's performance was unsatisfactory and, accordingly, he was offered the opportunity to resign. Further, management is of the opinion that the claim of Mr. Goldsmith is baseless because the Company had cause to terminate its relationship with Mr. Goldsmith. The Company intends to vigorously defend this lawsuit and has instituted a counterclaim against Mr. Goldsmith. The Company believes that Mr. Goldsmith misrepresented his background and capabilities to induce it and/or Coates Motorcycle Company, Ltd. ("CMC") to hire him. The Company is also contending that certain of Mr. Goldsmith's business decisions were made to further his self interest rather than the interests of the Company. The Company believes that Mr. Goldsmith's claims have no basis in fact and, accordingly, that the outcome of this legal action will not be material to its financial condition or results of operations. Efforts by the court to settle this matter have been unsuccessful. The Company filed a new motion for summary judgment contending that based on its corporate by-laws, Mr. Goldsmith's employment contract required approval by the board of directors which was never given. Goldsmith filed a cross-motion for summary judgment. Both of these motions were denied by the court in December 2011. Another motion to dismiss Goldsmith's complaint was filed by the Company because it appears that Mr. Goldsmith withheld or destroyed evidence. This motion was argued on November 16, 2012 and dismissed without prejudice. Trial is currently scheduled for May 28, 2013. The Company intends to vigorously defend against Mr. Goldsmith's claims and pursue its counterclaims.

The Company has, in prior years, without prejudice to its position that the employment contract never became effective, accrued compensation under the terms of the employment agreement for accounting purposes only, of \$96,000 of his salary. Although the Company does not intend to make any payments to Mr. Goldsmith in connection with this employment agreement, this amount is included in accounts payable and accrued liabilities in the accompanying consolidated balance sheets.

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

26. RECENTLY ISSUED ACCOUNTING STANDARD

In December 2011, the Financial Accounting Standards Board issued Accounting Standards Update No. 2011-11, "Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities". This update requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. Such disclosures are required for:

- Recognized financial instruments and derivative instruments that are offset in accordance with either Section 210-20-45 or Section 815-10-45
- Recognized financial instruments and derivative instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with either Section 210-20-45 or Section 815-10-45.

This standard is effective for interim periods and fiscal years beginning on or after January 1, 2013. The Company does not believe that adoption of this standard will have a material effect on its consolidated financial statements.

27. SUBSEQUENT EVENTS

Conversion of Convertible Promissory Note

Subsequent to September 30, 2012, a \$44,000 convertible promissory note, including accrued interest thereon was converted by the holder into 1,436,187 unregistered shares of the Company's common stock.

Promissory Notes to Related Parties

Subsequent to September 30, 2012, the Company issued additional 17% promissory notes to George J. Coates and received proceeds therefrom of \$53,000. Mr. and Mrs. Coates have made loans to the Company from time to time for working capital purposes but they are not obligated to continue to do so in the future.

Sale of Common Stock and Warrants

Subsequent to September 30, 2012, the Company sold 795,455 shares of its common stock, 500,000 warrants to purchase one share of its common stock at an exercise price of \$0.06 per share and 1,090,910 warrants to purchase one share of its common stock at an exercise price of \$0.055 per share in consideration for \$45,000 received from the son of a director. These transactions were private sales of unregistered, restricted securities pursuant to stock purchase agreements.

Issuance of Common Stock for Anti-dilution

Subsequent to September 30, 2012, the Company issued 2,544,074 shares of its common stock to George J. Coates pursuant to an anti-dilution agreement in effect and recorded related stock-based compensation expense of \$136,000.

Sale of Common Stock

In October 2012, the Company sold 384,615 restricted shares of its common stock in consideration for \$25,000, or \$0.065 per share to one of its directors.

Conversion of Promissory Note to Related Party

In October 2012, by mutual agreement, a promissory note with a balance of \$47,000, inclusive of principal and accrued interest thereon held by a director was converted into 473,272 restricted shares of common stock representing a conversion price per share of \$0.10.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Cautionary Notice Regarding Forward-Looking Statements

The information contained in Item 2 contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Actual results may materially differ from those projected in the forward-looking statements as a result of certain risks and uncertainties set forth in this report. Although management believes that the assumptions made and expectations reflected in the forward-looking statements are reasonable, there is no assurance that the underlying assumptions will, in fact, prove to be correct or that actual results will not be different from expectations expressed in this report.

This filing contains a number of forward-looking statements which reflect management's current views and expectations with respect to our business, strategies, products, future results and events, and financial performance. All statements made in this filing other than statements of historical fact, including statements addressing operating performance, events, or developments which management expects or anticipates will or may occur in the future, including statements related to distributor channels, volume growth, revenues, profitability, new products, adequacy of funds from operations, statements expressing general optimism about future operating results, and non-historical information, are forward looking statements. In particular, the words "believe," "expect," "intend," "anticipate," "estimate," "may," variations of such words, and similar expressions identify forward-looking statements, but are not the exclusive means of identifying such statements, and their absence does not mean that the statement is not forward-looking. These forward-looking statements are subject to certain risks and uncertainties, including those discussed below. Our actual results, performance or achievements could differ materially from historical results as well as those expressed in, anticipated, or implied by these forward-looking statements. We do not undertake any obligation to revise these forward-looking statements to reflect any future events or circumstances.

Readers should not place undue reliance on these forward-looking statements, which are based on management's current expectations and projections about future events, are not guarantees of future performance, are subject to risks, uncertainties and assumptions (including those described below), and apply only as of the date of this filing. Our actual results, performance or achievements could differ materially from the results expressed in, or implied by, these forward-looking statements. Factors which could cause or contribute to such differences include, but are not limited to, the risks to be discussed in our Annual Report on Form 10-K and quarterly reports on Form 10-Q and in the press releases and other communications to shareholders issued by us from time to time which attempt to advise interested parties of the risks and factors which may affect our business. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

Overview

Coates International, Ltd. ("we", "CIL" or the "Company") has been developing over a period of more than 20 years a patented, Coates spherical rotary valve ("CSRV") 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 CSRV system technology ("CSRV 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 CSRV Engines produced only ultra-low levels of harmful emissions while in operation. Engines operating on the CSRV system technology can be powered by a wide selection of fuels. We believe that these three major advantages of the CSRV 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.

We have completed development of the Coates spherical rotary valve engine technology. This technology has been successfully applied to natural gas fueled industrial electric power generator engines, automobile engines, residential generators and high performance racing car engines. We have also designed and retrofitted the CSRV system technology into a diesel engine which is suitable for and can be applied to heavy trucks. We have been primarily investing our management time and resources in securing new working capital and developing plans for transitioning to large scale production in order to be properly positioned to take advantage of this technology as it achieves acceptance in the marketplace. This includes consideration of an optimal location, shipping logistics, manufacturing capacity and quality of the labor pool for such large scale manufacturing. In the fourth quarter of 2011, we identified cracks on the lower engine heads that resulted from a defect in the manufacturing by one of our suppliers. Based on our testing of the Gen Set to confirm our resolution of this problem, we believe we have determined the cause of this cracked head condition. We are continuing our testing of a CSRV Gen Set to which the changes needed to resolve this problem have been applied. We are working on trying to raise sufficient working capital in excess of our fixed expenses and current obligations, so that we can procure new cast-steel head castings and begin larger scale production, after which, we intend to undertake field testing of the generators. We intend to manufacture engines and/or license the CSRV system technology to third-party Original Equipment Manufacturers ("OEM's") for multiple applications and uses.

We believe that the CSRV system technology delivers significant competitive advantages over technology currently applied in conventional internal combustion engines, including substantial improvement in fuel efficiency, a substantial reduction in harmful emissions, adaptability to almost any type of engine fuel and longer intervals between scheduled engine maintenance. This technology has been successfully applied to CSRV Gen Sets, automobile engines, a 35-KW synchronous residential generator and a high performance racing car engine.

We may also conduct new research and development activities in connection with applying this technology to other commercially feasible internal combustion engine applications. We believe the CSRV system technology has wide applicability to all types of products powered by internal combustion engines.

Initially, we intend to sell the CSRV Gen Sets to Almont Energy, Inc. ("Almont"), the successor in interest to Well to Wire Energy, Inc. ("WWE") with respect to (i) a sublicense agreement covering the territory of Canada; and, (ii) certain rights to a sublicense covering the territory of the United States. Almont is a privately held, independent third party entity based in Alberta, Canada. The business plan of Almont assumes the purchase of a substantial number of CSRV Gen Sets over a 5-year period commencing upon our ramp up of production to fulfill their orders. Almont's purchase of CSRV Gen Sets from us will be made by way of standard purchase orders, issued based on market and customer demand. Almont has projected that annual demand for Gen Sets could be as much as 11,000 units if the Company can achieve full scale production. Almont plans to finance its purchases from cash flow and by way of project and/or equipment financing, proceeds from issuance of equity or corporate debt instruments and conventional bank financing.

Our ability to establish large scale 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 common stock to Dutchess Opportunity Fund II, LP under the equity line of credit, sales of our equity and/or debt securities through private placement offerings, issuances of promissory notes to related parties, issuances of convertible promissory notes, pursuing and entering into additional sublicensing agreements with OEM's and/or distributors, additional payments from Almont towards the escrow agreement Release Payment, US Licensing fees and positive working capital generated from sales of our CSRV products to Almont and others. 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.

We are actively engaged in efforts to raise working capital to fund our ongoing operations and the ramp up of production of our products incorporating the CSRV system technology.

Non-binding Preliminary Letter of Intent to Merge with S.W.T. in China

In May 2011, we entered into a non-binding letter of intent with S.W.T., an established heavy equipment manufacturer in China and The Coates Trust. The letter expressed the mutual intent of the parties to exchange shares of common stock between us and S.W.T., make a cash payment to the shareholders of S.W.T. and issue shares of our common stock to The Coates Trust in consideration for a CSRV technology license for China. The transaction would be subject to required governmental approvals and a number of other prerequisite conditions. In September 2011, we determined that the risk of proceeding with this merger transaction as contemplated at that time, was greater than anticipated. Accordingly, we will either continue to explore the possibility of restructuring the merger transaction or taking a simpler approach that would enable us to have access to the manufacturing capabilities of S.W.T., while affording both companies the opportunity to benefit from CSRV system technology related manufacturing activities. At this time, further discussions with S.W.T. are on hold until the management of S.W.T. can observe the CSRV system technology performing in the Canadian oil and gas fields.

Manufacturing Subsidiaries

We formed a wholly-owned manufacturing subsidiary in 2011 with the intent to establish manufacturing operations within the State of Oklahoma. This subsidiary has been inactive as discussions with the state for a package of business and tax incentives are on hold. We formed another manufacturing subsidiary in 2012 with the intent to establish manufacturing operations within another state. We own approximately 66% of this subsidiary. It has been inactive pending the outcome of discussions with this state for a package of business and tax incentives intended to induce us to establish its manufacturing operations within this state. We are precluded from disclosing the name of this state, until discussions are concluded, by a confidentiality agreement.

Sublicense Agreements with Almont Energy, Inc.

In January 2010, we consented to the assignment of our sublicensing agreement with WWE to Almont. This sublicense agreement exclusively licenses within Canada the use of the CSRV system technology for industrial engines to be 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 total of \$5,153,000 by WWE and Almont under these agreements. Additional provisions of the Canadian License agreement are as follows:

- Sublicensee shall have the exclusive right to use, lease and sell electric power generators designed with the CSRV 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 adjust the price per generator accordingly to consider the savings, if any, realized from economies of scale inherent in high volume production of the CSRV units. In the event Sublicensee fails to purchase the minimum 120 Coates generator engines during any year, Sublicensee will automatically lose its exclusivity. We have temporarily waived this provision due to the delay in delivery of Gen Sets. In such a case, Licensee would retain non-exclusive rights to continue to use and sell the CSRV generator engine in the territory of Canada.
- 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 system technology will remain with the Company.

In January 2010, we 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 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 new \$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”). As successor to WWE, Almont is expected to continue to make non-refundable periodic payments to us in unspecified amounts as partial payments of the Release Payment until the Release Payment has been paid in full. 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 \$3,653,000 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 currently \$5,847,000. To the extent that Almont is not successful or experiences delays in remitting the balance of the Release Payment, the Company’s cash flow, results of operations and financial condition could be adversely affected.

In connection with the assignment of the Canadian and US License from WWE to Almont, we waived all events of default by WWE under the Escrow Agreement in existence and extended the date by which the entire Release Payment must be paid (the “Release Payment Due Date”), which lapsed in March 2012. We have agreed to extend the Release Payment Date under the Escrow Agreement until March 2014 to compensate for the delay caused by the late delivery of Gen Sets. 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. Payment of the Release Payment is dependent on us starting up production to fulfill Almont’s orders.

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 Territory, provided that Almont satisfies the minimum annual purchase commitment of 120 internal combustion engines incorporating the CSRV system technology, the Coates Engines and all component parts. 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.

The \$49 million portion of the US License fee is payable in quarterly installments in an amount equal to 5% of Almont's prior quarter net profits. In any event, the entire balance of the licensing fee must be paid in full on or before February 19, 2016.

Acceleration of the balance of the licensing fee payments 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.

Plan of Operation

We have completed development of the CSRV system technology-based generator engine and, once we raise sufficient new working capital, are prepared to commence the production phase of our operations. Initially, we intend to sell the engine generators to Almont, the successor in interest to WWE 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, Canada. We shipped the first CSRV system technology-based generator to Almont in the fourth quarter of 2010 and another such generator was shipped in 2011. In the fourth quarter of 2011, we identified cracks on the lower engine heads that resulted from a defect in the manufacturing by one of our suppliers. Based on our testing of the Gen Set to confirm our resolution of this problem, we believe we have determined the cause of this cracked head condition.

As soon as we raise sufficient working capital in excess of our fixed expenses and current obligations, we will procure new cast-steel head castings and will begin larger scale production, after which, we intend to undertake field testing of the generators. The business plan of Almont assumes the purchase of a substantial number of CSRV Units over the next 5 years. Almont's purchase of CSRV Units from us will be made by way of standard purchase orders, issued based on market and customer demand. Over the 5-year period, Almont has projected that annual demand for Gen Sets could be as much as 11,000 units if the Company can achieve full scale production. We are unable to confirm these orders until we have sufficient working capital in place to manufacture generators on a larger scale. Almont plans to finance its purchases from cash flow and by way of project and/or equipment financing, proceeds from issuance of equity or corporate debt instruments and conventional bank financing.

We intend to take advantage of the fact that essentially all the components of the CSRV generator engine may be readily sourced and acquired from subcontractors, and, accordingly, expect to manufacture the engine generator in the two following ways:

- Assembly – to develop assembly lines within owned manufacturing facilities. We intend to initially commence production of CSRV Units on a small scale. This will enable us to prove our concept for the CSRV system technology and we expect this will lead to substantial demand in the marketplace. We plan to address this demand by establishing large scale manufacturing operations in the United States. We are in the process of identifying a high capacity manufacturing plant in an appropriate location. Transitioning to large scale manufacturing is expected to require a substantial increase in our work force and substantial capital expenditures.
- Licensing the CSRV system technology to Original Equipment Manufacturers (“OEM’s”) – to take advantage of third party manufacturers’ production capacity and resources by entering into OEM agreements.

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.

Significant Estimates

The preparation of our financial statements in conformity with United States generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and 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 issued and certain limited anti-dilution rights granted to George J. Coates during 2011, assigning useful lives to the Company’s 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 – Three Months Ended September 30, 2012 Compared to the Three Months Ended September 30, 2011 (All amounts rounded to thousands of dollars)

There were no sales for the three months ended September 30, 2012 and 2011.

There were no revenues from research and development for the three months ended September 30, 2012 and 2011.

Sublicensing fee revenue for the three months ended September 30, 2012 and 2011, amounted to \$5,000 and \$5,000, respectively. The Company is recognizing the license deposit of \$300,000 on the Canadian License as revenue over the approximately 16-year remaining life of the last CSRV technology patent in force at that date.

Research and development expenses were \$94,000 and \$96,000 for the three months ended September 30, 2012 and 2011, respectively. Included in research and development expenses for the three months ended September 30, 2012 and 2011 were \$51,000 and \$42,000, respectively, of allocated compensation and benefits and \$41,000 and \$48,000, respectively, of allocated stock-based compensation expense. Also, included in research and development expenses were \$2,000 and \$6,000, respectively, of parts and materials.

General and administrative expenses increased to \$571,000 for the three months ended September 30, 2012 from \$369,000 in the corresponding period in 2011. This net increase of \$202,000 primarily resulted from the following: An increase in non-cash stock-based compensation expense of \$223,000 which primarily resulted from the issuance of restricted shares of common stock pursuant to an anti-dilution agreement which became effective January 1, 2012 valued at \$189,000 and an increase in stock option expense of \$34,000, an increase in real estate taxes of \$17,000, an increase in insurance of \$14,000, an increase in investor relations expenses of \$9,000, an increase in travel and entertainment of \$6,000, an increase in legal and professional fees of \$4,000 and an increase other expenses of \$1,000, offset by a decrease in patent maintenance costs of (\$28,000), a decrease in compensation and benefits of (\$27,000), a decrease in marketing costs of (\$6,000), a decrease in dues and subscriptions of \$4,000, a decrease in office expenses of (\$4,000) and a decrease in utilities of (\$3,000).

Depreciation and amortization increased by \$5,000 to \$22,000 for the three months ended September 30, 2012 from \$17,000 for the three months ended September 30, 2011.

Other operating income (expense) for the three months ended September 30, 2012, consisted of an increase in the fair value of embedded derivative liabilities amounting to \$17,000, compared to an increase in the fair value of embedded derivative liabilities amounting to \$208,000 for the three months ended September 30, 2011, in connection with convertible promissory notes outstanding. In accordance with GAAP, the fair value of these embedded liabilities is required to be remeasured at each balance sheet reporting date.

Interest expense, net, amounted to \$105,000 for the three months ended September 30, 2012, a decrease of \$20,000 from interest expense, net of \$125,000 incurred in the comparable 2011 period.

The change in deferred tax assets for the three months ended September 30, 2012 and 2011 was fully offset by a valuation allowance, resulting in a \$-0- net income tax provision.

We incurred net losses of (\$804,000) and (\$811,000) for the three months ended September 30, 2012 and 2011, respectively.

Results of Operations – Nine Months Ended September 30, 2012 Compared to the Nine Months Ended September 30, 2011 (All amounts rounded to thousands of dollars)

There were no sales for the nine months ended September 30, 2012. For the nine months ended September 30, 2011, sales amounted to \$125,000 arising from the sale of a CSRV natural gas powered industrial electric power Gen Set to Almont. Gross margin on this sale after cost of sales of \$65,000 amounted to \$60,000.

There were no revenues from research and development for the nine months ended September 30, 2012. Revenues from research and development for the nine months ended September 30, 2011, amounted to \$150,000.

Sublicensing fee revenue for the nine months ended September 30, 2012 and 2011, amounted to \$15,000 and \$10,000, respectively. The Company is recognizing the license deposit of \$300,000 on the Canadian License as revenue over the approximately 16-year remaining life of the last CSRV technology patent in force at that date.

Research and development expenses were \$416,000 and \$172,000 for the nine months ended September 30, 2012 and 2011, respectively. Included in research and development expenses for the nine months ended September 30, 2012 and 2011 were \$151,000 and \$92,000, respectively, of allocated compensation and benefits and \$218,000 and \$54,000, respectively, of allocated stock-based compensation expense. Also, included in research and development expenses were \$47,000 and \$26,000, respectively, of parts and materials.

General and administrative expenses increased to \$2,836,000 for the nine months ended September 30, 2012 from \$1,234,000 in the corresponding period in 2011. This net increase of \$1,602,000 primarily resulted from the following: An increase in non-cash stock-based compensation expense of \$1,565,000 which resulted from the issuance of restricted shares of common stock valued at \$1,456,000 pursuant to an anti-dilution agreement which became effective January 1, 2012 and an increase in stock option expense of \$109,000, an increase in legal and professional fees of \$62,000, an increase in investor relations expense of \$56,000, an increase in insurance expense of \$25,000, an increase in real estate taxes of \$15,000, an increase in offering costs of \$7,000, an increase in printing costs of \$6,000 and an increase in miscellaneous taxes of \$3,000, offset by a decrease in compensation and benefits of (\$65,000), a decrease in marketing costs of (\$19,000), a decrease in office expenses of (\$14,000), a decrease in utility costs of (\$9,000), a decrease in regulatory filing costs of (\$8,000), a decrease in travel and entertainment of (\$8,000), a decrease in parts expense of (\$4,000), a decrease in patent maintenance costs of (3,000) and a net decrease in other general and administrative expenses of (\$7,000).

Depreciation and amortization decreased by \$4,000 to \$49,000 for the nine months ended September 30, 2012 from \$53,000 for the nine months ended September 30, 2011.

Other operating income (expense) for the nine months ended September 30, 2012, consisted of an increase in the fair value of embedded derivative liabilities amounting to \$26,000, compared to an increase in the fair value of embedded derivative liabilities amounting to \$282,000 for the nine months ended September 30, 2011, in connection with convertible promissory notes outstanding. In accordance with GAAP, the fair value of these embedded liabilities is required to be remeasured at each balance sheet reporting date.

Interest expense, net, amounted to \$380,000 for the nine months ended September 30, 2012, an increase of \$11,000 from interest expense, net of \$369,000 incurred in the comparable 2011 period.

The change in deferred tax assets for the nine months ended September 30, 2012 and 2011 was fully offset by a valuation allowance, resulting in a \$-0- net income tax provision.

We incurred net losses of (\$3,692,000) and (\$1,890,000) for the nine months ended September 30, 2012 and 2011, respectively. This included expenses requiring an outlay of cash amounting to \$1,244,000 and \$999,000, respectively, and non-cash expenses, net of non-cash revenues, of \$2,448,000 and \$891,000 for the nine months ended September 30, 2012 and 2011, respectively.

Liquidity and Capital Resources (All amounts rounded to thousands of dollars)

Our cash position at September 30, 2012 was \$16,000, a decrease of (\$37,000) from the cash position of \$53,000 at December 31, 2011. We had negative working capital of (\$3,796,000) at September 30, 2012 which represents a (\$43,000) decrease from the (\$3,753,000) of negative working capital at December 31, 2011. Current liabilities of \$4,173,000 at September 30, 2012, decreased by \$55,000 from the \$4,228,000 balance at December 31, 2011. Current liabilities were primarily comprised of a mortgage loan in the amount of \$1,590,000, accounts payable and accrued liabilities of \$1,585,000, promissory notes to related parties totaling \$471,000, embedded derivative liabilities related to convertible promissory notes of \$281,000, deferred compensation payable of \$151,000, net carrying value of convertible promissory notes of \$66,000 and unearned revenue of \$29,000.

Operating activities utilized cash of (\$897,000) during the nine months ended September 30, 2012, which primarily consisted of a net loss for the period of (\$3,692,000), decreased by non-cash stock-based compensation expense of \$2,080,000, non-cash interest expense of \$298,000, depreciation and amortization of \$49,000, a non-cash increase of \$26,000 in the fair value of the embedded liabilities related to convertible promissory notes and non-cash financing costs of \$9,000, and increased by non-cash sublicensing revenues of (\$15,000). In addition, we realized net additional operating cash of \$348,000 from a net increase in accounts payable and accrued liabilities of \$287,000, a net reduction in inventory of \$40,000 and a reduction in deferred offering costs and other assets of \$20,000.

There were no investing activities for the nine months ended September 30, 2012.

Financing activities generated net cash of \$869,000 for the nine months ended September 30, 2012, consisting of proceeds from issuance of common stock and warrants of \$544,000, issuance of convertible notes amounting to \$212,000 and issuance of promissory notes to related parties, net of repayments amounting to \$154,000, offset by a \$41,000 partial repayment of the principal amount of a mortgage loan.

In the opinion of management, we will be required to continue to raise additional working capital to fully achieve our objectives in order to enter the production phase of our operations and continue research and development activities in connection with developing other commercially viable applications of our CSRV system technology to internal combustion engines. Various potential sources of such additional working capital are anticipated to come from one or more of the following: sales of shares of common stock to Dutchess Opportunity Fund II, LP under the equity line of credit, sales and shipments of natural gas-fueled industrial electric power CSRV Gen Sets to Almont, cash flows from payments by Almont under the escrow agreement, additional issuances of convertible promissory notes, issuances of promissory notes to related parties and private sales of common stock and common stock warrants. 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 in our challenge to secure needed additional working capital. There can be no assurance that we will be able to obtain the necessary working capital for our production phase on a time frame that will enable us to carry out our current business plans.

Contractual Obligations and Commitments

The following table summarizes our contractual obligations at September 30, 2012 (rounded to thousands of dollars):

	Total	Due Within	
		2012	2013
Mortgage loan payable	\$ 1,590,000	\$ 15,000	\$ 1,575,000
Promissory notes to related parties	471,000	471,000	-
Deferred compensation	151,000	151,000	-
Convertible promissory notes	160,000	-	160,000
10% promissory note	10,000	10,000	-
Total	\$ 2,382,000	\$ 647,000	\$ 1,735,000

Total non-cash compensation cost related to nonvested stock options at September 30, 2012 that has not been recognized was approximately \$269,000. This non-cash stock-based compensation expense will be recognized in the future over a remaining weighted average period of approximately nine months.

Going Concern (All amounts rounded to thousands of dollars)

As shown in the accompanying consolidated financial statements, we incurred a net loss for the nine months ended September 30, 2012 of (\$3,692,000), and have incurred substantial net losses since inception while engaging primarily in research and development. As of September 30, 2012, we had accumulated losses of (\$30,389,000) and had negative working capital of (\$3,796,000). 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 in our challenge to secure needed additional working capital. These factors raise substantial doubt about our ability to continue as a going concern. Our Independent Registered Public Accounting Firm has stated in its independent auditors' report on our financial statements as of December 31, 2011 and for the year then ended that these factors raise substantial doubt about our ability to continue as a going concern.

The doubt about our ability to continue to operate as a going concern has existed for a number of years. We have been successful in raising sufficient new working capital throughout that time to enable us to continue as a going concern and, although we can not provide assurances that we can be successful, we believe that we can continue to do so in the future. Management is continuing to carefully monitor its costs and is restricting variable costs to only those expenses that are necessary to carry out our business plans. We continue to actively seek out new sources of working capital; however, there can be no assurance that we will be successful in these efforts.

Potential sources of such new working capital include sales of our equity and/or debt securities through private placement and/or secondary public offerings, pursuing and entering into additional sublicensing agreements with OEM's and/or distributors, additional payments from Almont towards the Escrow Agreement Release Payment and US Licensing fees and positive working capital generated from sales of our CSRV products to Almont and others. 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 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 accompanying consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES

(a) *Evaluation of Disclosure Controls.* Pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934 (the "Exchange Act"), we carried out an evaluation, with the participation of our management, including our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") (our principal financial and accounting officer), of the effectiveness of our 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, our CEO and CFO concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit 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 our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

(b) *Changes in Internal Control over Financial Reporting.* There have been no changes in our internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Not applicable.

ITEM 1A. RISK FACTORS

Not required.

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

During the third quarter ended September 30, 2012, the following transactions involved unregistered sale of our equity securities:

An aggregate of \$52,000 principal amount of a convertible promissory notes, plus interest thereon amounting \$2,040, were converted by the holder into 1,459,003 unregistered shares of our common stock.

We sold 1,295,454 restricted shares of our common stock, 1,500,000 common stock warrants to purchase one share of our common stock at an exercise price of \$0.06 per share and 1,090,910 common stock warrants to purchase one share of our common stock at an exercise price of \$0.055 per share in consideration for \$75,000 received from the son of a director.

We issued a \$75,000 principal amount, 8% convertible promissory note and received net proceeds of \$71,000, net of financing costs of \$4,000. The note is convertible into unregistered shares of our common stock at any time beginning six months after issuance. The conversion rate is equal to 61% of the average of the three lowest closing bid prices of the stock during the ten trading days prior to the date of conversion.

We issued 2,784,457 restricted shares of common stock to George J. Coates pursuant to an anti-dilution agreement.

All of the above shares were issued pursuant to an exemption from registration contained in Section 4(2) of the Securities Act of 1933.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS.

Exhibit Number	Description
31.1 *	Section 302 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2 *	Section 302 Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1 **	Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2 **	Certification of Principal Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS +	XBRL Instance Document
101.SCH +	XBRL Taxonomy Schema
101.CAL +	XBRL Taxonomy Calculation Linkbase
101.DEF +	XBRL Taxonomy Definition Linkbase
101.LAB +	XBRL Taxonomy Label Linkbase
101.PRE +	XBRL Taxonomy Presentation Linkbase
101.DEF+	XBRL Taxonomy Extension Definition Linkbase Document

* Filed herewith.

**Furnished herewith.

+ XBRL (eXtensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

SIGNATURES

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

COATES INTERNATIONAL, LTD.

Date: November 21, 2012

By: /s/ George J. Coates

George J. Coates
President, Chief Executive Officer
and Principal Executive Officer

Date: November 21, 2012

By: /s/ Barry C. Kaye

Barry C. Kaye
Treasurer, Chief Financial Officer
and Principal Financial Officer

CERTIFICATION
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, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Coates International, Ltd. (the “registrant”):
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(s) 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(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) 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 the registrant’s disclosure controls and procedures; and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
 - 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(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: November 21, 2012

By: /s/ George J. Coates

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

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

I, Barry C. Kaye, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Coates International, Ltd. (the “registrant”):
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(s) 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(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) 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 the registrant’s disclosure controls and procedures; and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
 - 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(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: November 21, 2012

By: /s/ Barry C. Kaye

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

**CERTIFICATION 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 Quarterly Report of Coates International, Ltd. (the "Company") on Form 10-Q for the period ended September 30, 2012 (the "Report"), I, George J. Coates, President and Chief Executive Officer of the Company, hereby certify 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), as applicable, 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: November 21, 2012

By: /s/ George J. Coates

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

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION 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 Quarterly Report of Coates International, Ltd. (the "Company") on Form 10-Q for the period ended September 30, 2012 (the "Report"), I, Barry C. Kaye, Treasurer and Chief Financial Officer of the Company, hereby certify 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), as applicable, 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: November 21, 2012

By: */s/ Barry C. Kaye*

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

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.