

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, 2016**

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.)

**2100 Highway 34, Wall Township, New Jersey 07719**  
(Address of principal executive offices) (Zip Code)

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

**N/A**

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

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"/> (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 9, 2016, the Registrant had 3,060,518,968 shares of its common stock, par value \$0.0001 per share issued and outstanding, 50,000 shares of Series A Preferred Stock, par value \$0.001, issued and outstanding and 24,539,007 shares of Series B Convertible Preferred Stock, par value \$0.001, issued and outstanding.

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

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**SEPTEMBER 30, 2016**

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

Coates International, Ltd.  
Balance Sheets

	September 30, 2016 (Unaudited)	December 31, 2015
Assets		
Current Assets		
Cash	\$ 11,411	\$ 29,207
Inventory, net	246,545	218,018
Other current assets	6,133	9,117
Total Current Assets	<u>264,089</u>	<u>256,342</u>
Property, plant and equipment, net	2,087,573	2,108,990
Deferred licensing costs, net	39,236	42,449
Total Assets	<u>\$ 2,390,898</u>	<u>\$ 2,407,781</u>
Liabilities and Stockholders' Deficiency		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 2,076,605	\$ 2,022,568
Promissory Notes to related parties	1,446,482	1,455,882
Deferred Compensation Payable	1,155,102	922,144
Convertible Promissory Notes, net of unamortized discount	61,831	408,110
Derivative liability related to convertible promissory notes	158,196	632,927
Unearned Revenue	150,595	150,595
Current portion of license deposits	60,725	60,725
Current portion of mortgage loan payable	60,000	60,000
Current portion of finance lease obligation, net of unamortized discount	-	19,349
Total Current Liabilities	<u>5,169,536</u>	<u>5,732,300</u>
Non-current portion of mortgage loan payable	1,283,158	1,328,159
Non-current portion of license deposits	631,975	646,375
Total Liabilities	<u>7,084,669</u>	<u>7,706,834</u>
Commitments and Contingencies	-	-
Stockholders' Deficiency		
Preferred stock, \$0.001 par value, 100,000,000 shares authorized: Series A Preferred Stock, 1,000,000 shares designated, 50,000 shares issued and outstanding at September 30, 2016 and December 31, 2015	50	50
Series B Convertible Preferred Stock, 25,000,000 and 5,000,000 shares designated, 16,092,505 and 3,492,749 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively	16,093	3,493
Common Stock, \$0.0001 par value, 12,000,000,000 shares authorized, 2,959,323,883 shares issued and outstanding at September 30, 2016 and 2,000,000,000 shares authorized, 1,036,791,116 shares issued and outstanding at December 31, 2015	295,932	103,679
Additional paid-in capital	59,816,516	51,564,723
Accumulated deficit	(64,822,362)	(56,970,998)
Total Stockholders' Deficiency	<u>(4,693,771)</u>	<u>(5,299,053)</u>
Total Liabilities and Stockholders' Deficiency	<u>\$ 2,390,898</u>	<u>\$ 2,407,781</u>

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

**Coates International, Ltd.**  
**Statements of Operations**  
**(Unaudited)**

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Sublicensing fee revenue	\$ 4,800	\$ 4,800	\$ 14,400	\$ 14,400
Total Revenues	<u>4,800</u>	<u>4,800</u>	<u>14,400</u>	<u>14,400</u>
Expenses:				
Research and development costs	1,250	93,198	189,773	282,942
Compensation and benefits	4,212,206	1,490,842	7,070,179	7,276,854
General and administrative expenses	109,842	179,425	333,397	456,721
Depreciation and amortization	12,249	12,619	36,122	40,378
Total Operating Expenses	<u>4,335,547</u>	<u>1,776,084</u>	<u>7,629,471</u>	<u>8,056,895</u>
Loss from Operations	<u>(4,330,747)</u>	<u>(1,771,284)</u>	<u>(7,615,071)</u>	<u>(8,042,495)</u>
Other Income (Expense):				
Decrease (increase) in estimated fair value of embedded derivative liabilities	56,950	(467,639)	474,731	(395,744)
Loss on conversion of convertible notes	(54,932)	(18,257)	(124,962)	(256,327)
Interest expense, net	(110,641)	(187,038)	(586,063)	(588,556)
Total Other Income (Expense)	<u>(108,623)</u>	<u>(672,934)</u>	<u>(236,294)</u>	<u>(1,240,627)</u>
Loss Before Income Taxes	<u>(4,439,370)</u>	<u>(2,444,218)</u>	<u>(7,851,365)</u>	<u>(9,283,122)</u>
Provision for income taxes	-	-	-	-
Net Loss	<u>\$ (4,439,370)</u>	<u>\$ (2,444,218)</u>	<u>\$ (7,851,365)</u>	<u>\$ (9,283,122)</u>
Basic net loss per share	<u>\$ (0.00)</u>	<u>\$ (0.00)</u>	<u>\$ (0.00)</u>	<u>\$ (0.01)</u>
Basic weighted average shares outstanding	<u>2,508,814,075</u>	<u>944,977,964</u>	<u>1,723,247,751</u>	<u>731,942,336</u>
Diluted net loss per share	<u>\$ (0.00)</u>	<u>\$ (0.00)</u>	<u>\$ (0.00)</u>	<u>\$ (0.01)</u>
Diluted weighted average shares outstanding	<u>2,508,814,075</u>	<u>944,977,964</u>	<u>1,723,247,751</u>	<u>731,942,336</u>

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

**Coates International, Ltd.**  
**Condensed Statements of Cash Flows**  
**For the Nine Months Ended September 30,**  
**(Unaudited)**

	<u>2016</u>	<u>2015</u>
Net Cash Used in Operating Activities	\$ (449,121)	\$ (806,599)
Cash Used in Investing Activities:		
Acquisition of property, plant and equipment	(11,493)	(37,090)
Total Cash Used in Investing Activities	<u>(11,493)</u>	<u>(37,090)</u>
Cash Flows Provided by (Used in) Financing Activities:		
Issuance of common stock under equity purchase agreements	150,000	258,060
Issuance of promissory notes to related parties	162,443	60,000
Issuance of convertible promissory notes	154,000	653,000
Issuance of common stock and warrants to related party	45,000	-
Repayment of mortgage loan	(45,000)	(45,125)
Repayment of promissory notes to related parties	(15,000)	(166,000)
Finance Lease Obligation Payments	(8,625)	(51,089)
Repayment of convertible promissory notes	-	(52,750)
Net Cash Provided by Financing Activities	<u>442,818</u>	<u>656,096</u>
Net Decrease in Cash	(17,796)	(187,594)
Cash, beginning of period	29,207	263,526
Cash, end of period	<u>\$ 11,411</u>	<u>\$ 75,933</u>
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for interest	\$ 80,022	\$ 140,897
Supplemental Disclosure of Non-cash Financing Activities:		
Conversion of convertible promissory notes	<u>\$ 639,700</u>	<u>\$ 748,093</u>

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

**Coates International, Ltd.**  
**Notes to Financial Statements**  
**September 30, 2016**  
**(All amounts rounded to thousands of dollars)**  
**(Unaudited)**

**1. THE COMPANY AND BASIS OF PRESENTATION**

*Nature of Organization*

Coates International, Ltd. (the “Company” or “CIL”) has acquired the exclusive licensing rights to the patented Coates spherical rotary valve (“CSRV<sup>®</sup>”) system technology in North America, Central America and South America (the “CSRV<sup>®</sup> License”). The CSRV<sup>®</sup> system technology has been developed over a period of more than 20 years by the Company’s founder George J. Coates, President and Chief Executive Officer, and his son Gregory G. Coates. The CSRV<sup>®</sup> system technology is adaptable for use in piston-driven internal combustion engines of many types and has been patented in the United States and numerous countries throughout the world. The Company is endeavoring to raise working capital to commence production of natural gas powered CSRV<sup>®</sup> industrial electric power generator sets (“Gen Sets”) and is also seeking to enter into sublicense agreements with third party, original equipment manufacturers (“OEM’s”) which provide for licensing fees. The Company is also continuing with research and development of a hydrogen reactor to harvest Hydroxy-Gas from water with the intent to power the Company’s products, including large industrial Gen Sets. George J. Coates, owner of the hydrogen reactor technology, has committed to license this technology to the Company once the related patent protection is in place.

Management believes that the CSRV<sup>®</sup> engines provide the following advantages as compared to conventional internal combustion engines designed with “poppet valves”:

- Improved fuel efficiency
- Lower levels of harmful emissions
- Adaptability to numerous types of engine fuels
- Longer engine life
- Longer intervals between engine servicing

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

*Basis of Presentation*

The accompanying condensed financial statements include the accounts of the Company. In the opinion of the Company's management, the condensed consolidated financial statements reflect all adjustments, which are normal and recurring in nature, necessary for fair financial statement presentation. The preparation of these condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the amounts reported in these condensed consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates. Certain prior period amounts in the condensed financial statements have been reclassified to conform to the current period's presentation.

These condensed financial statements and accompanying notes should be read in conjunction with the Company's annual financial statements and the notes thereto included in its Annual Report on Form 10-K for the year ended December 31, 2015 and the Company's quarterly financial statements and the notes thereto included in its Quarterly Reports on Form 10-Q for the six months ended June 30, 2016 and for the three months ended March 31, 2016.

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

As shown in the accompanying financial statements, the Company has incurred recurring losses from operations and, as of September 30, 2016, had a stockholders' deficiency of (\$4,694,000). In addition, the current economic environment, which is characterized by tight credit markets, investor uncertainty about how to safely invest their funds and low investor confidence, has introduced additional risk and difficulty to the Company's challenge to secure needed additional working capital. These factors raise substantial doubt about the Company's ability to continue as a going concern. Management has instituted a cost control program intended to restrict variable costs to only those expenses that are necessary to complete its activities related to entering the production phase of operations, develop additional commercially feasible applications of the CSRV<sup>®</sup> system technology, seek additional sources of working capital and cover general and administrative costs in support of such activities. The Company has been actively undertaking efforts to secure new sources of working capital. At September 30, 2016, the Company had negative working capital of (\$4,905,000) compared with negative working capital of (\$5,476,000) at the end of 2015.

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

*Use of Estimates*

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

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

The Company maintains a cash balance with one financial institution. Monies on deposit are fully insured by the Federal Deposit Insurance Corporation.

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

**3. FAIR VALUE OF FINANCIAL INSTRUMENTS**

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

With the exception of convertible promissory notes, the carrying amount of these items approximates their fair value because of the short term maturity of these instruments. The convertible promissory notes are reported at their estimated fair value, determined as described in more detail in Note 14.

*Limitations*

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

**4. LICENSING AGREEMENT AND DEFERRED LICENSING COSTS**

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



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

At September 30, 2016, and December 31, 2015, deferred licensing costs, comprised of expenditures for patent costs incurred pursuant to the CSRV<sup>®</sup> licensing agreement, net of accumulated amortization, amounted to \$39,000 and \$42,000, respectively. Amortization expense for the three months ended September 30, 2016 and 2015 amounted to \$1,000 and \$1,000, respectively. Amortization expense for the nine months ended September 30, 2016 and 2015 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<sup>®</sup> system technology in the territory of Canada in the oil and gas industry (the “Canadian License”). Almont is also the assignee of a separate research and development agreement (“R&D Agreement”) which requires that Almont pay the remaining balance of an additional \$5,000,000 fee to the Company in consideration for the development and delivery of certain prototype engines. The Company completed development of the prototypes in accordance with this agreement at the end of 2007. The R&D Agreement has not been reduced to the form of a signed, written agreement.

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

The Escrow Agreement requires that Almont, as the assignee, make a payment (“Release Payment”) to the Company equal to the then remaining unpaid balance of the Canadian License licensing fee, the R&D Agreement fee and the down payment of \$1,000,000 required under the US License. It is not likely that Almont will be able to make additional payments of the Release Payment until the Company can raise sufficient new working capital to commence production and ship Gen Sets to Almont. At September 30, 2016, the remaining balance of the Release Payment due to the Company was \$5,847,000.

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

In February 2015, the Company granted a non-exclusive distribution sublicense to Renown Power Development, Ltd., a China-based sales and distribution company (“Renown”) covering the territory defined as the Western Hemisphere. Under this sublicense, Renown will be permitted to sell, lease and distribute CSRV<sup>®</sup> products. This sublicense provides for payment of licensing fees to the Company amounting to US\$100 million. In 2014, the Company received an initial non-refundable deposit of US\$498,000. In addition, after Renown receives aggregate cash flow of US\$10,000,000, it is required to pay the Company 25% of all funds it receives from any and all sources until the entire balance of US\$100 million licensing fee is paid in full. In the event that Renown completes one or more capital raises aggregating US\$300 million or more, the remaining unpaid balance of the US\$100 million licensing fee shall become immediately due and payable. The rights and obligations per the agreement shall terminate upon the expiration of the last to expire patent and any improvement patents added thereto.

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

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

Coates Power has agreed to initially source its production parts and components from the Company. In February 2015, the Company received an order from Coates Power for approximately \$131,000 of production parts and components, at cost, in connection with its plans to manufacture two initial Gen Sets. In June, 2015, by mutual consent of the parties, it was agreed that the Company would assemble two completed Gen Sets for shipment to Coates Power in China in lieu of shipping the parts and components. This amount is included in deposits in the accompanying balance sheet at September 30, 2016.

**7. INVENTORY**

Inventory consisted of the following:

	September 30, 2016	December 31, 2015
Raw materials	\$ 559,000	\$ 554,000
Work-in-process	75,000	51,000
Less: Reserve for obsolescence	(387,000)	(387,000)
Total	<u>\$ 247,000</u>	<u>\$ 218,000</u>

**8. LICENSE DEPOSITS**

License deposits consist of monies received as deposits on sublicense agreements, primarily comprised of deposits from Renown in the amount of \$498,000 and from Almont in the amount of \$300,000. These deposits are to be recognized as income on a straight-line basis over the remaining period until expiration of the last remaining CSRV<sup>®</sup> patent in force in 2027. Through September 30, 2016, the Company has recognized a total of \$106,000 of the Almont deposit as revenue. Based on ongoing planning with the government of China, the Company expects that sublicense-related activities by Renown may commence within the next twelve months and that it will begin recognizing revenue at that time. Recognition of revenue from the Almont license is included in the statements of operations for the three months and nine months ended September 30, 2016 and 2015. The current portion of the license deposits represents the portion of the license deposits expected to be recognized as revenue within one year from the balance sheet date. The balance of the license deposits is included in non-current license deposits.

Sublicensing fee revenue for the three months ended September 30, 2016 and 2015 amounted to \$5,000 and \$5,000, respectively. Sublicensing fee revenue for the nine months ended September 30, 2016 and 2015 amounted to \$14,000 and \$14,000, respectively.

**9. PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment at cost, less accumulated depreciation, consist of the following:

	September 30, 2016	December 31, 2015
Land	\$ 1,235,000	\$ 1,235,000
Building	964,000	964,000
Building improvements	83,000	83,000
Machinery and equipment	689,000	689,000
Furniture and fixtures	57,000	46,000
	<u>3,028,000</u>	<u>3,017,000</u>
Less: Accumulated depreciation	(940,000)	(908,000)
Total	<u>\$ 2,088,000</u>	<u>\$ 2,109,000</u>

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

Depreciation expense amounted to \$11,000 and \$12,000 for the three months ended September 30, 2016 and 2015, respectively. Depreciation expense amounted to \$33,000 and \$37,000 for the nine months ended September 30, 2016 and 2015, respectively.

#### 10. MORTGAGE LOAN PAYABLE

The Company has a mortgage loan on the land and building that serves as its headquarters and research and development facility which bears interest at the rate of 7.5% per annum and matures in July 2018. Interest expense for the three months ended September 30, 2016 and 2015 amounted to \$26,000 and \$28,000, respectively. Interest expense for the nine months ended September 30, 2016 and 2015 amounted to \$78,000 and \$73,000, respectively. The loan requires monthly payments of interest, plus \$5,000 which is being applied to the principal balance. The remaining principal balance at September 30, 2016 and December 31, 2015 was \$1,343,000 and \$1,388,000, respectively. The mortgage loan may be prepaid in whole, or, in part, at any time without penalty.

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

#### 11. FINANCE LEASE OBLIGATION

In August 2013, the Company entered into a sale/leaseback financing arrangement pursuant to which it sold its research and development and manufacturing equipment in consideration for net cash proceeds of \$133,000. This lease terminated in February 2016, upon which the Company reacquired title to the equipment. The effective interest rate on this lease was 36.6%.

In accordance with GAAP, this sale/leaseback was required to be accounted for as a financing lease. Under this accounting method, the equipment and accumulated depreciation remained on the Company's books and records as if the Company still owned the equipment.

For the three months ended September 30, 2016 and 2015, interest expense amounted to \$-0- and \$7,000, respectively. For the nine months ended September 30, 2016 and 2015, interest expense amounted to \$2,000 and \$26,000, respectively. These amounts are included in interest expense in the accompanying statements of operations.

#### 12. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities are as follows:

	September 30, 2016	December 31, 2015
Legal and professional fees	\$ 1,446,000	\$ 1,368,000
General and administrative expenses	350,000	163,000
Accrued interest expense	166,000	376,000
Research and development costs	115,000	115,000
Total	<u>\$ 2,077,000</u>	<u>\$ 2,022,000</u>

### 13. PROMISSORY NOTES TO RELATED PARTIES

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

During the nine months ended September 30, 2016 and 2015, the Company issued, in a series of transactions, promissory notes to George J. Coates and received cash proceeds of \$162,000 and \$60,000, respectively, repaid promissory notes to George J. Coates in the aggregate principal amount of \$15,000 and \$120,000, respectively, and also paid him \$43,000 of accrued interest in 2015.

In May 2016, by mutual consent, Mr. Coates converted \$100,000 of principal and interest into 90,909,091 restricted shares of common stock at the closing trading price of the stock on the date of conversion of \$0.0011 per share.

In July 2016, by mutual consent, George J. Coates converted \$120,000 of principal and interest into 200,000,000 restricted shares of common stock at the closing trading price of the stock on the date of conversion of \$0.0006 per share.

In August 2016, by mutual consent, George J. Coates converted \$252,000 of principal and interest into 279,549,056 restricted shares of common stock at the closing trading price of the stock on the date of conversion of \$0.0009 per share.

The promissory notes are payable on demand and provide for interest at the rate of 17% per annum, compounded monthly. At September 30, 2016, the outstanding balance was \$1,000, including accrued interest thereon.

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

The Company has a non-interest bearing promissory note due to Gregory G. Coates which is payable on demand. Interest is being imputed on this promissory note at the rate of 10% per annum. Interest expense for the three months ended September 30, 2016 and 2015 amounted to \$36,000 and \$36,000, respectively. Interest expense for the nine months ended September 30, 2016 and 2015 amounted to \$108,000 and \$108,000, respectively. During the nine months ended September 30, 2015, the Company repaid promissory notes to Gregory G. Coates in the aggregate principal amount of \$15,000. At September 30, 2016, the outstanding principal balance was \$1,438,000.

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

During the nine months ended September 30, 2016 and 2015, the Company repaid promissory notes to Bernadette Coates, spouse of George J. Coates, in the aggregate principal amount of \$-0- and \$31,000, respectively. The promissory notes are payable on demand and provide for interest at the rate of 17% per annum, compounded monthly. Interest expense for the three months ended September 30, 2016 and 2015 amounted to \$3,000 and \$3,000, respectively. Interest expense for the nine months ended September 30, 2016 and 2015 amounted to \$10,000 and \$11,000, respectively. At September 30, 2016, the outstanding balance amounted to \$80,000, including accrued interest thereon.

Unpaid accrued interest on these promissory notes amounting to \$75,000 is included in accounts payable and accrued liabilities in the accompanying balance sheet at September 30, 2016.

### 14. CONVERTIBLE PROMISSORY NOTES AND EMBEDDED DERIVATIVE LIABILITY

From time to time, the Company issues convertible promissory notes, the proceeds of which are used for general working capital purposes. At September 30, 2016, there was \$124,000 principal amount of convertible promissory notes outstanding. During the nine months ended September 30, 2016 and 2015, \$165,000 and \$676,000 of convertible promissory notes were issued, respectively. Outstanding notes may be converted into unregistered shares of the Company's common stock at a discount ranging from 30% to 38% of the defined trading price of the common stock on the date of conversion. The defined trading prices are based on the trading price of the stock during a defined period ranging from fifteen to twenty-five trading days immediately preceding the date of conversion. The conversion rate discount establishes a beneficial conversion feature ("BCF") or unamortized discount, which is required to be valued and accreted to interest expense over the six-month period until the conversion of the notes into restricted shares of common stock is permitted. In addition, the conversion formula meets the conditions that require accounting for convertible notes as derivative liability instruments. The effective interest rate on the outstanding convertible notes at September 30, 2016 ranged from 147% to 183%. The unamortized discount on the outstanding convertible notes at September 30, 2016 and December 31, 2015 amounted to \$62,000 and \$150,000, respectively.

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Notes to Financial Statements - (Continued)

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

One convertible promissory note with a balance of \$50,000 is convertible in monthly installments in an amount determined by the noteholder of up to \$50,000, plus accrued interest. The Company may elect, at its option to repay each monthly installment in whole, or in part, in cash, without penalty. The amount of each installment not paid in cash is converted into shares of the Company's common stock. This convertible note also requires that the conversion price be re-measured 23 trading days after the conversion shares are originally delivered. If the re-measured conversion price is lower, then the Company is required to issue additional conversion shares to the noteholder.

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

- Level 1 – Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 – Inputs include quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly.
- Level 3 – Inputs to the fair value measurement are unobservable inputs or valuation techniques.

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

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

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Notes to Financial Statements - (Continued)

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

	September 30, 2016	December 31, 2015
Level 1 Inputs	\$ -	\$ -
Level 2 Inputs	158,000	633,000
Level 3 Inputs	-	-
Total	<u>\$ 158,000</u>	<u>\$ 633,000</u>

In a series of transactions, during the nine months ended September 30, 2016, convertible promissory notes with an aggregate principal balance of \$665,000, including accrued interest thereon were converted into 1,209,182,017 unregistered shares of common stock. The Company incurred a loss on these conversions amounting to \$125,000 for the nine months ended September 30, 2016.

In a series of transactions, during the nine months ended September 30, 2015, convertible promissory notes with an aggregate principal balance of \$790,000, including accrued interest thereon were converted into 459,875,350 unregistered shares of common stock. The Company incurred a loss on these conversions amounting to \$256,000 for the nine months ended September 30, 2015. In two transactions, during the nine months ended September 30, 2015, the Company also repaid \$55,000 of a convertible promissory note, including accrued interest thereon without penalty.

At September 30, 2016, the Company had reserved 904,147,000 shares of its unissued common stock for conversion of convertible promissory notes.

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

## 15. CAPITAL STOCK

### *Common Stock*

The Company's common stock is traded on OTC Pink Sheets. Investors can find stock quotes and market information for the Company at [www.otcmarkets.com](http://www.otcmarkets.com) market system under the ticker symbol COTE. Effective June 17, 2016, the Company amended its Certificate of Incorporation to increase the number of authorized shares of common stock, par value, \$0.0001 per share (the "Common Stock") to 12,000,000,000.

The following common stock transactions occurred during the nine months ended September 30, 2016:

- In a series of transactions during the nine months ended September 30, 2016, convertible promissory notes with an aggregate principal balance of \$665,000, including accrued interest thereon were converted into 1,209,182,017 unregistered shares of common stock.
- In a series of transactions during the nine months ended September 30, 2016, the Company issued 87,892,603 registered shares of its common stock to Southridge Partners II LP ("Southridge") under the 2015 EP Agreement, as discussed in Note 20, in consideration for \$150,000. The proceeds were used for general working capital. The Company is required to deliver shares of its common stock to Southridge with each Put Notice based on the dollar amount of the Put Notice and the trading price of the common stock. At September 30, 2016, there were 24,539,007 shares of common stock previously delivered and held by Southridge which had not been sold. These shares may be held by Southridge until sold under future Put Notices or until the Company requests that they be returned.

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Notes to Financial Statements - (Continued)

- During the nine months ended September 30, 2016, the Company made private sales, pursuant to stock purchase agreements, of 55,000,000 unregistered shares of its common stock and 55,000,000 common stock warrants to purchase one unregistered share of its common stock at exercise prices ranging from \$0.005 to \$0.001 per share, in consideration for \$45,000.
- During the nine months ended September 30, 2016, in a series of transactions by mutual consent between the Company and George J. Coates, \$472,000 principal amount of promissory notes, including accrued interest, were converted into 570,458,147 restricted, unregistered shares of the Company's common stock at conversion rates ranging from \$0.0006 to \$0.0011 per share, which was the closing trading price of the stock on the respective dates of conversion.

The following common stock transactions occurred during the nine months ended September 30, 2015:

- In a series of transactions during the nine months ended September 30, 2015, convertible promissory notes with an aggregate principal balance of \$790,000, including accrued interest thereon were converted into 459,875,350 unregistered shares of common stock.
- In a series of transactions during the nine months ended September 30, 2015, the Company issued 45,910,165 registered shares of its common stock to Southridge Partners II LP ("Southridge") under equity purchase agreements in consideration for \$258,000. The proceeds were used for general working capital. The Company is required to deliver shares of its common stock to Southridge with each Put Notice based on the dollar amount of the Put Notice and the trading price of the common stock.

At September 30, 2016, on a pro forma basis, the approximate number of shares of common stock that would be issued if all of the Company's outstanding convertible notes eligible for conversion, had been converted was 100,531,899. None of the outstanding stock options and warrants were assumed to be exercised since the trading price of the stock on September 30, 2016 was below the exercise price of such instruments.

*Preferred Stock and anti-dilution rights*

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

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

- Series A Preferred Stock, par value \$0.001 per share ("Series A"), 1,000,000 shares designated, 50,000 and 50,000 shares issued and outstanding as of September 30, 2016 and December 31, 2015, respectively. Shares of Series A entitle the holder to 10,000 votes per share on all matters brought before the shareholders for a vote. These shares are not entitled to receive dividends or share in distributions of capital and have no liquidation preference. All outstanding shares of Series A are owned by George J. Coates.

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Notes to Financial Statements - (Continued)

- Series B Convertible Preferred Stock, par value \$0.001 per share, 25,000,000 and 5,000,000 shares designated, 16,092,505 and 3,492,749 shares issued and outstanding as of September 30, 2016 and December 31, 2015, respectively. Shares of Series B do not earn any dividends and may be converted at the option of the holder at any time beginning on the second annual anniversary date after the date of issuance into 1,000 unregistered shares of the Company's common stock. Holders of Series B are entitled to one thousand votes per share held, on all matters brought before the shareholders for a vote.

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

The Company has anti-dilution provisions in place for key executives which are triggered upon the issuance of new shares of its common stock to individuals that are not direct Coates family members or entities that are not controlled by Coates family members. These anti-dilution provisions do not apply to new shares of common stock issued in connection with exercises of employee stock options, a secondary public offering of the Company's securities or a merger or acquisition. These provisions are as follows:

- For each such new share of common stock issued, shares of Series B will be issued to Mr. Coates equal to that number of shares of Series B required to maintain his ownership percentage of shares of common stock outstanding on a pro forma basis, at 78%, which was his ownership percentage as of December 31, 2002. As a result of the conversions of Mr. Coates' promissory notes into 570,458,147 shares of common stock, as discussed in Note 13, his ownership percentage to be maintained through anti-dilution increased to 83.5%.
- For each such new share of common stock issued, shares of Series B will be issued to Gregory G. Coates in order to maintain his ownership percentage of common stock at 5.31% of the pro forma number of shares of common stock outstanding, assuming all shares of Series B were converted into common stock. This was his percentage ownership of common stock at December 31, 2002.
- For each such new share of common stock issued, shares of Series B will be issued to Barry C. Kaye in order to maintain his ownership percentage of common stock at a calculated percentage of the pro forma number of shares of common stock outstanding, assuming all shares of Series B were converted into common stock. This calculated percentage, which was 0.04157% at September 30, 2016, is equal to the weighted average percentage ownership of common stock he purchased, based on the number of shares of common stock outstanding on each date he acquired shares of common stock. This percentage is subject to adjustment if he acquires or disposes of shares of the Company's common stock in the future.



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Notes to Financial Statements - (Continued)

The following presents by year, the number of shares of Series B held and the year that they become eligible for conversion into shares of common stock.

	Total	2016	2017	2018
George J. Coates	15,016,987	541,933	2,708,430	11,766,624
Gregory G. Coates	997,620	40,593	184,382	772,645
Barry C. Kaye	77,898	2,976	14,435	60,487
Total	<u>16,092,505</u>	<u>585,502</u>	<u>2,907,247</u>	<u>12,599,756</u>

For the nine months ended September 30, 2016, 11,766,624, 772,645 and 60,487 shares of Series B were issued to George J. Coates, Gregory G. Coates and Barry C. Kaye, respectively, having an estimated fair value of \$6,749,000, \$447,000 and \$35,000, respectively. These amounts were included in stock-based compensation expense in the accompanying statement of operations for the nine months ended September 30, 2016.

For the nine months ended September 30, 2015, 2,463,772, 167,726 and 13,131 shares of Series B were issued to George J. Coates, Gregory G. Coates and Barry C. Kaye, respectively, having an estimated fair value of \$6,874,000, \$468,000 and \$37,000, respectively. These amounts were included in stock-based compensation expense in the accompanying statement of operations for the nine months ended September 30, 2015.

In the event that all of the 16,092,505 shares of Series B outstanding at September 30, 2016 were converted, once the conversion restrictions lapse, an additional 16,092,505,000 new restricted shares of common stock would be issued. On a pro forma basis, based on the number of shares of common stock outstanding at September 30, 2016, this would dilute the ownership percentage of non-affiliated stockholders from 71.3% to 8.5%.

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

#### 16. UNEARNED REVENUE

Unearned revenue at September 30, 2016, consisted of the following:

- A deposit received with an order for two CSR<sup>®</sup>V Gen Sets from Coates Power, Ltd., a China-based unaffiliated manufacturing company in the amount of \$132,000.
- A \$19,000 non-refundable deposit from Almont in connection with its order for a natural gas fueled electric power CSR<sup>®</sup>V engine generator.

#### 17. SUBLICENSING FEE REVENUE

Sublicensing fee revenue for the three months ended September 30, 2016 and 2015 amounted to \$5,000 and \$5,000, respectively. Sublicensing fee revenue for the nine months ended September 30, 2016 and 2015 amounted to \$14,000 and \$14,000, respectively. The Company is recognizing the license deposit of \$300,000 on the Canadian License as revenue on a straight-line basis over the approximate remaining life until 2027 of the last CSR<sup>®</sup>V technology patent in force.

#### 18. LOSS PER SHARE

At September 30, 2016, there were stock warrants outstanding to purchase 90,344,911 shares of common stock at exercise prices ranging from \$0.0005 to \$0.12 per share, vested stock options outstanding to acquire 12,470,000 shares of common stock at exercise prices ranging from \$0.028 to \$0.44 per share and \$50,000 of convertible promissory notes eligible for conversion, which on a pro forma basis, assuming they would have been converted on September 30, 2016, would have been convertible into 100,531,899 shares of common stock.

At September 30, 2015, there were stock warrants outstanding to purchase 35,344,911 shares of common stock at exercise prices ranging from \$0.02 to \$0.35 per share and vested stock options outstanding to acquire 12,500,000 shares of common stock at exercise prices ranging from \$0.028 to \$1.00 per share and \$79,000 of convertible promissory notes eligible for conversion.

For the nine months ended September 30, 2016 and 2015, 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 of earnings per share would have been anti-dilutive.

## 19. STOCK OPTIONS

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

The Company established a 2014 Stock Option and Incentive Plan (the "2014 Stock Plan") which was adopted by the Company's board on May 30, 2014. On March 2, 2015, the 2014 Stock Plan, by consent of George J. Coates, majority shareholder, was adopted by our shareholders. The 2014 Stock Plan provides for the grant of stock-based awards to employees, officers and directors of, and consultants or advisors to, the Company and its subsidiaries, if any. Under the 2014 Stock Plan, the Company may grant ISO's, non-statutory options, restricted stock and other stock-based awards. ISO's may be granted only to employees of the Company. A total of 50,000,000 shares of common stock may be issued upon the exercise of options or other awards granted under the 2014 Stock Plan. The maximum number of shares with respect to which awards may be granted during any one year to any employee under the 2014 Stock Plan shall not exceed 25% of the 50,000,000 shares of common stock covered by the 2014 Stock Plan. At September 30, 2016, none of the shares of common stock authorized under the 2014 Stock Plan had been granted as stock options or awards.

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

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.

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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, 2016 no stock options were granted. During the nine months ended September 30, 2015, no stock options were granted and 703,000 stock options with an exercise price of \$0.028 per share became vested. There were no unvested stock options outstanding at September 30, 2016.

During the three months ended September 30, 2016 and 2015, the Company did not incur any stock-based compensation expense related to employee stock options. During the nine months ended September 30, 2016 and 2015, the Company recorded non-cash stock-based compensation expense related to employee stock options amounting to \$0- and \$7,000, respectively. At September 30, 2016, all stock-based compensation expense related to outstanding stock options had been fully recognized.

Details of the stock options outstanding under the Company's Stock Option Plans are as follows:

	Exercise Price Per Share	Number Outstanding	Weighted Average Remaining Contractual Life	Number Exercisable	Weighted Average Exercise Price	Weighted Average Fair Value Per Stock Option at Date of Grant
Balance, 9/30/16	\$ 0.028 – \$0.44	12,470,000	10	12,470,000	\$ 0.182	\$ 0.169

No stock options were exercised, forfeited or expired during the nine months ended September 30, 2016 and 2015.

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

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

The valuation assumptions were determined as follows:

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

## 20. EQUITY PURCHASE AND REGISTRATION RIGHTS AGREEMENTS

### *Southridge Partners II LP*

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

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

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

During the nine months ended September 30, 2016, the Company sold 87,892,603 registered shares of common stock to Southridge and received proceeds of \$150,000 under the 2015 EP Agreement.

During the nine months ended September 30, 2015, the Company (i) sold all of the 40,000,000 registered shares of common stock to Southridge and received proceeds of \$207,000, thereby resulting in the termination of this 2014 EP Agreement, and (ii) sold 5,910,165 registered shares of common stock to Southridge and received proceeds of \$51,000 under the 2015 EP Agreement.

## 21. 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 \$1,750,000 and \$589,000 for the three months ended September 30, 2016 and 2015, respectively. Deferred tax assets increased by \$3,145,000 and \$3,473,000 for the nine months ended September 30, 2016 and 2015, respectively. These amounts were fully offset by a corresponding increase in the tax valuation allowance resulting in no net change in deferred tax assets, respectively, during these periods.

No liability for unrecognized tax benefits was required to be reported at September 30, 2016 and December 31, 2015. 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 2013 through 2015, 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, 2016 and 2015, there were no penalties or interest related to the Company's income tax returns.

At September 30, 2016, the Company had available, \$20,069,000 of net operating loss carryforwards which may be used to reduce future federal taxable income, expiring between 2018 and 2036 and \$9,767,000 of net operating loss carryforwards which may be used to reduce future state taxable income, expiring between 2029 and 2036.

## 22. RELATED PARTY TRANSACTIONS

### *Issuances and Repayments of Promissory Notes to Related Parties*

Issuances and repayments of promissory notes to related parties during the nine months ended September 30, 2016 and 2015, are discussed in detail in Note 13.

### *Issuances of Preferred Stock*

Shares of Series B Convertible Preferred Stock awarded to George J. Coates, Gregory G. Coates and Barry C. Kaye during the nine months ended September 30, 2016 and 2015 are discussed in detail in Note 15.

### *Personal Guaranty and Stock Pledge*

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

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Notes to Financial Statements - (Continued)

*Compensation and Benefits Paid*

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

	For the nine months ended September 30,	
	2016	2015
George J. Coates (a) (b)	\$ 17,000	\$ 13,000
Gregory G. Coates (c)	131,000	137,000
Bernadette Coates (d)	3,000	4,000

- (a) For the nine months ended September 30, 2016 and 2015, George J. Coates earned additional base compensation of \$183,000 and \$188,000, respectively, payment of which is being deferred until the Company has sufficient working capital. These amounts are included in deferred compensation in the accompanying balance sheets at September 30, 2016 and 2015.
- (b) During the nine months ended September 30, 2016 and 2015, George J. Coates was awarded 11,766,624 and 2,463,772 shares of Series B Convertible Preferred Stock, respectively, with an estimated fair value of \$6,749,000 and \$6,875,000, respectively, for anti-dilution.
- (c) During the nine months ended September 30, 2016 and 2015, Gregory G. Coates was awarded 772,645 and 167,726 shares of Series B Convertible Preferred Stock, respectively, with an estimated fair value of \$447,000 and \$468,000, respectively, for anti-dilution.
- (d) For the nine months ended September 30, 2016 and 2015, Bernadette Coates earned additional base compensation of \$50,000 and \$50,000, respectively, payment of which is being deferred until the Company has sufficient working capital. These amounts are included in deferred compensation in the accompanying balance sheets at September 30, 2016 and 2015.

During the nine months ended September 30, 2016 and 2015, Barry C. Kaye, Treasurer and Chief Financial Officer was paid compensation of \$1,000 and \$73,000, respectively. For the three months ended September 30, 2016 and 2015, Mr. Kaye earned compensation of \$25,000 and \$26,000, respectively, which was not paid and is being deferred until the Company has sufficient working capital to remit payment to him. For the nine months ended September 30, 2016 and 2015, Mr. Kaye earned compensation of \$74,000 and \$87,000, respectively, which was not paid and is being deferred until the Company has sufficient working capital to remit payment to him. During the nine months ended September 30, 2016, the Company agreed to pay Mr. Kaye interest on the balance of his deferred compensation retroactive to when it began being deferred in May 2012 and, accordingly, recorded interest expense of \$90,000. This amount is reflected in interest expense in the accompanying statements of operations for the three and nine months ended September 30, 2016. Interest continues to be accrued on the unpaid balance thereafter. At September 30, 2016, the total amount of Mr. Kaye's unpaid, deferred compensation, including accrued interest thereon, was \$270,000. This amount is included in accounts payable and accrued liabilities in the accompanying balance sheet at September 30, 2016. During the nine months ended September 30, 2016 and 2015, Barry C. Kaye was awarded 60,487 and 13,131 shares of Series B Convertible Preferred Stock, respectively, with an estimated fair value of \$35,000 and \$37,000, respectively, for anti-dilution.

### 23. CONTRACTUAL OBLIGATIONS AND COMMITMENTS

The following table summarizes the Company's contractual obligations and commitments at September 30, 2016:

	<u>Total</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
Promissory notes to related parties	\$ 1,447,000	\$ 1,447,000	\$ -	\$ -
Mortgage loan payable	1,343,000	60,000	60,000	1,223,000
Deferred compensation	1,155,000	1,155,000	-	-
Convertible promissory notes	124,000	50,000	74,000	-
Total	<u>\$ 4,069,000</u>	<u>\$ 2,712,000</u>	<u>\$ 134,000</u>	<u>\$ 1,223,000</u>

### 24. LITIGATION AND CONTINGENCIES

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

### 25. RECENTLY ISSUED ACCOUNTING STANDARDS

#### *Revenue Recognition*

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"), which amends the existing accounting standards for revenue recognition. ASU 2014-09 is based on principles that govern the recognition of revenue at an amount an entity expects to be entitled to when products are transferred to customers. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606) – Deferral of the Effective Date, which defers the effective date of ASU 2014-09 for one year and permits early adoption. Accordingly, the Company may adopt the standard in either its first quarter of 2018 or 2019.

In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606) – Identifying Performance Obligations and Licensing ("ASU 2016-10"), which amends the guidance in ASU 2014-09 related to identifying performance obligations and accounting for licenses of intellectual property. The Company will adopt ASU 2016-10 with ASU 2014-09. The Company is currently evaluating the impact of adopting the new revenue recognition standard, as amended, but does not expect it to have a material impact on its financial statements.

#### *Stock Compensation*

In March 2016, the FASB issued ASU No. 2016-09, Compensation – Stock Compensation (Topic 718), which simplified certain aspects of the accounting for share-based payment transactions, including income taxes, classification of awards and classification in the statement of cash flows. ASU 2016-09 will be effective for the Company beginning in its first quarter of 2018. The Company is currently evaluating the impact of adopting the new stock compensation standard, but does not expect it to have a material impact on its financial statements.

#### *Financial Instruments*

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments – Overall (Subtopic 825-10) ("ASU 2016-01"), which updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments. ASU 2016-01 will be effective for the Company beginning in its first quarter of 2019. The Company does not believe the adoption of the new financial instruments standard will have a material impact on its financial statements.

*Inventory Measurement*

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

**26. SUBSEQUENT EVENTS**

*Conversion of Convertible Promissory Notes*

In October 2016, \$30,000 principal amount of convertible promissory notes, including accrued interest, was converted into 71,428,571 unregistered, restricted shares of the Company's common stock.

*Issuance of Anti-dilution shares*

In October 2016, the Company issued 756,165, 48,290 and 3,781 shares of Series B Convertible Preferred Stock to George J. Coates, Gregory G. Coates and Barry C. Kaye, respectively, representing anti-dilution shares related to newly issued shares of common stock. The estimated fair value of these shares was \$295,000, \$19,000 and \$1,000, respectively.

*Issuances of Promissory Notes to Related Parties*

In October and November 2016, the Company issued promissory notes to George J. Coates and received cash proceeds of \$3,000 and repaid promissory notes to George J. Coates amounting to \$1,000. The promissory notes are payable on demand and provide for interest at the rate of 17% per annum, compounded monthly.

*Deferred Compensation*

As of November 10, 2016, George J. Coates, Barry C. Kaye and Bernadette Coates agreed to additional deferral of their compensation amounting to \$29,000, \$14,000 and \$8,000, respectively, bringing their total aggregate deferred compensation to \$942,000, \$194,000 and \$250,000, respectively.

*Sale of Common Stock and Warrants*

In October 2016, the Company made a private sale, pursuant to a stock purchase agreement, of 20,000,000 unregistered shares of its common stock and 20,000,000 common stock warrants to purchase one unregistered share of its common stock at an exercise price of \$0.0005 per share, in consideration for \$10,000.



## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **Cautionary Notice Regarding Forward-Looking Statements**

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

From time to time, forward-looking statements also are included in our other periodic reports on Forms 10-K and 8-K, in our press releases, in our presentations, on our website and in other materials released to the public. Any or all of the forward-looking statements included in this Report and in any other reports or public statements made by us are not guarantees of future performance and may turn out to be inaccurate. These forward-looking statements represent our intentions, plans, expectations, assumptions and beliefs about future events and are subject to risks, uncertainties and other factors. Many of those factors are outside of our control and could cause actual results to differ materially from the results expressed or implied by those forward-looking statements. In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than we have described. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this Report. All subsequent written and oral forward-looking statements concerning other matters addressed in this Report and attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this Report. For a discussion of factors that we believe could cause our actual results to differ materially from expected and historical results see "Item 1A - Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2015 filed with the Securities and Exchange Commission.

### **Background**

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

In the second quarter of 2016, we successfully completed work on a new natural gas powered industrial electric, 14.0-liter engine generator, by substantially retrofitting a new generator from Cummins Power Systems to incorporate our CSRV<sup>®</sup> system technology, along with a number of engineering design changes. We are currently demonstrating this unit in connection with prospective transactions in negotiations. This unit is expected to serve as the basis of our global design standard for large scale manufacturing.

In February 2015, we granted a US\$100 million non-exclusive distribution sublicense to a China-based sales and distribution company that covers distribution in the territory of the Western Hemisphere. We also undertook to procure parts and components to commence limited production of our Gen Sets.

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

- Better fuel efficiency
- Reduced harmful emissions

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

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

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

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

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

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

## Plan of Operation

### *Manufacturing, Sales and Distribution*

As discussed above, we are using the recently completed CSRV<sup>®</sup> system technology, retrofitted Cummins-based engine generator in our efforts to attract new licensing transactions and other manufacturing activities. We will also need to raise sufficient new working capital to ramp-up our own manufacturing and distribution operations.

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

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

### *Sublicensing*

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

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

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

Coates Power has agreed to initially source two completed Gen Sets from us. We received a deposit for these two Gen Sets of approximately \$131,000.

### **Significant Estimates**

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

### **Results of Operations for the Three Months Ended September 30, 2016 and 2015**

Our principal business activities and efforts for the three months ended September 30, 2016 and 2015 were devoted to (i) undertaking efforts to raise additional working capital in order to fund ongoing operations in 2016 and (ii) commencing production of a limited number of CSRV<sup>®</sup> Industrial Generator Sets in the United States during 2015, including procurement of parts.

Although we incurred substantial net losses for the three months ended September 30, 2016 and 2015 of (\$4,439,370) and (\$2,444,218), respectively, it is important to consider that a substantial portion of these losses resulted from non-cash expenses required to be recorded for financial reporting purposes in accordance with GAAP. These net losses should be considered in view of the fact that actual cash used by operating activities amounting to (\$143,262) and (\$377,234) for the three months ended September 30, 2016 and 2015, respectively, was significantly less than these reported net losses.

### **Revenue**

There were no sales for the three months ended September 30, 2016 and 2015.

Sublicensing fee revenue for the three months ended September 30, 2016 and 2015 amounted to \$4,800 and \$4,800, respectively. Sublicensing fees are being recognized by amortizing the license deposit of \$300,000 on the Canadian License over the approximate remaining life of the last CSRV<sup>®</sup> technology patent in force.

### **Expenses**

#### *Research and Development Expenses*

There were minimal research and development activities for the three months ended September 30, 2016. Research and development activities for the three months ended September 30, 2015 were primarily related to continuing refinement of production parts and components for CSRV<sup>®</sup> industrial Gen Sets and, to a lesser extent, the hydrogen reactor project. Research and development expenses decreased by \$91,948 to \$1,250 in 2016 from \$93,198 in 2015.

### *Compensation and Benefits*

Compensation and benefits increased by \$2,721,364 to \$4,212,206 for the three months ended September 30, 2016 from \$1,490,842 for the three months ended September 30, 2015. This increase was primarily due to an increase in non-cash stock-based compensation of \$2,631,397. Stock-based compensation arose from issuances of Series B Convertible Preferred Stock to George J. Coates, Gregory G. Coates and Barry C. Kaye, for anti-dilution.

### *General and Administrative Expenses*

General and administrative expenses decreased by (\$69,583) to \$109,842 for the three months ended September 30, 2016 from \$179,425 for the three months ended September 30, 2015. This net decrease in 2016 resulted from decreases in financing costs of (\$12,120), legal and professional fees of (\$11,854), non-capitalizable equipment of (\$11,844) building expenses of (\$10,185), marketing costs of (\$7,500), state sales and other taxes of (\$7,251), utilities of (\$3,639), office expenses of (\$1,902), property taxes of (\$1,839) and all other expenses, net of (\$1,449).

### *Depreciation and Amortization*

Depreciation and amortization expense decreased to \$12,249 for the three months ended September 30, 2016 from \$12,619 for the three months ended September 30, 2015.

### **Loss from Operations**

A loss from operations of (\$4,330,747) was incurred for the three months ended September 30, 2016 compared with a loss from operations of (\$1,771,284) for the three months ended September 30, 2015. The increase in the amount of the loss from operations was primarily attributable to the increase in non-cash, stock-based compensation expense of (\$2,631,397), as discussed above.

### **Other Income (Expense)**

#### *Increase (decrease) in Estimated Fair Value of Embedded Liabilities*

The estimated fair value of embedded liabilities, which relates to outstanding convertible promissory notes, is remeasured at each balance sheet date. For the three months ended September 30, 2016 and 2015, other income (expense) was recorded to reflect the decrease (increase) in the fair value of embedded liabilities of \$56,950 and (\$467,639), respectively.

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

For the three months ended September 30, 2016 and 2015, the Company realized a loss on conversion of convertible notes of (\$54,932) and (\$18,257), respectively.

#### *Interest Expense*

Interest expense decreased to (\$110,641) for the three months ended September 30, 2016 from (\$187,038) in 2015. Interest expense in 2016 consisted of non-cash interest related to convertible promissory notes of \$29,962, interest on promissory notes and deferred compensation to related parties of \$51,351, mortgage loan interest of \$25,983 and net other interest of \$3,345.

Interest expense in 2015 consisted of non-cash interest related to convertible promissory notes of \$131,519, interest on promissory notes to related parties of \$17,032, mortgage loan interest of \$28,547, interest expense related to the sale/leaseback of equipment of \$7,466 and net other interest of \$2,474.

## **Deferred Taxes**

For the three months ended September 30, 2016 and 2015, the change in deferred taxes was fully offset by a valuation allowance, resulting in a \$-0- net income tax provision.

## **Net Loss**

For the three months ended September 30, 2016, we incurred a net loss of (\$4,439,370) or (\$0.00) per share, as compared with net loss of (\$2,444,218) or (\$0.00) per share for three months ended September 30, 2015. The increase in the amount of the net loss was primarily attributable to the increase in non-cash, stock-based compensation expense of (\$2,631,397), partially offset by the change in the increase (decrease) in estimated fair value of embedded liabilities of \$524,589, as discussed above.

## **Results of Operations for the Nine Months Ended September 30, 2016 and 2015**

Our principal business activities and efforts for the nine months ended September 30, 2016 and 2015 were devoted to (i) completing work on a new natural gas powered industrial electric, 14.0-liter engine generator, in 2016, by substantially retrofitting a new generator from Cummins Power Systems to incorporate our CSRV<sup>®</sup> system technology, including procurement of parts, along with a number of engineering design changes, (ii) undertaking efforts to raise additional working capital in order to fund ongoing operations and (iii) research and development of the CSRV<sup>®</sup> system technology and the hydrogen reactor technology.

Although we incurred substantial net losses for the nine months ended September 30, 2016 and 2015 of (\$7,851,365) and (\$9,283,122), respectively, it is important to consider that a substantial portion of these losses resulted from non-cash expenses required to be recorded for financial reporting purposes in accordance with GAAP. These net losses should be considered in view of the fact that actual cash used by operating activities amounting to (\$449,121) and (\$806,599) for the nine months ended September 30, 2016 and 2015, respectively, was significantly less than these reported net losses.

## **Revenue**

There were no sales for the nine months ended September 30, 2016 and 2015.

Sublicensing fee revenue for the nine months ended September 30, 2016 and 2015 amounted to \$14,400 and \$14,400, respectively. Sublicensing fees are being recognized by amortizing the license deposit of \$300,000 on the Canadian License over the approximate remaining life of the last CSRV<sup>®</sup> technology patent in force.

## **Expenses**

### *Research and Development Expenses*

Research and development activities for the nine months ended September 30, 2016 and 2015 were primarily related to continuing refinement of production parts and components for CSRV<sup>®</sup> Industrial Gen Sets and, to a lesser extent, the Hydrogen Reactor Project. Research and development expenses decreased by (\$93,169) to \$189,773 in 2016 from \$282,942 in 2015. This decrease resulted because there were only limited research and development activities in the third quarter of 2016.

### *Compensation and Benefits*

Compensation and benefits decreased by (\$206,675) to \$7,070,179 for the nine months ended September 30, 2016 from \$7,276,854 for the nine months ended September 30, 2015. This decrease was primarily due to a decrease in stock-based compensation of (\$294,705). Stock-based compensation arose from issuances of Series B Convertible Preferred Stock to George J. Coates, Gregory G. Coates and Barry C. Kaye, for anti-dilution.

### *General and Administrative Expenses*

General and administrative expenses decreased by (\$123,324) to \$333,397 for the nine months ended September 30, 2016 from \$456,721 for the nine months ended September 30, 2015. This net decrease in 2016 resulted from decreases in legal and professional fees of (\$43,403), financing costs of (\$20,162), net miscellaneous expense of (\$12,434), insurance of (\$12,246), building expenses of (\$11,867), sales and other taxes of (\$6,994), marketing costs of (\$6,667), printing costs of (\$6,467), investor relations expenses of (\$6,003), repairs and maintenance of (\$3,250), technology infrastructure costs of (\$3,067), office expenses of (\$2,486), utilities of (\$1,793), travel and entertainment of (\$1,657) and a net decrease in all other expenses of (\$3,398), partially offset by an increase in patent maintenance costs of \$18,570.

### *Depreciation and Amortization*

Depreciation and amortization expense decreased to \$36,122 for the nine months ended September 30, 2016 from \$40,378 for the nine months ended September 30, 2015.

### **Loss from Operations**

A loss from operations of (\$7,615,071) was incurred for the nine months ended September 30, 2016 compared with a loss from operations of (\$8,042,495) for the nine months ended September 30, 2015.

### **Other Income (Expense)**

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

The estimated fair value of embedded liabilities, which relates to outstanding convertible promissory notes, is remeasured at each balance sheet date. For the nine months ended September 30, 2016 and 2015, other income (expense) was recorded to reflect the decrease (increase) in the fair value of embedded liabilities of \$474,731 and (\$395,744), respectively.

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

For the nine months ended September 30, 2016 and 2015, the Company realized a loss on conversion of convertible notes of (\$124,962) and (\$256,327), respectively.

#### *Interest Expense*

Interest expense decreased to (\$586,063) for the nine months ended September 30, 2016 from (\$588,556) in 2015. Interest expense in 2016 consisted of non-cash interest related to convertible promissory notes of \$259,832, interest on promissory notes and deferred compensation to related parties of \$237,198, mortgage loan interest of \$78,173, interest expense related to the sale/leaseback of equipment of \$1,618 and net other interest of \$9,242.

Interest expense for the 2015 period consisted of non-cash interest related to convertible promissory notes of \$426,990, interest on promissory notes to related parties of \$57,002, mortgage loan interest of \$73,367, interest expense related to the sale/leaseback of equipment of \$26,455 and net other interest of \$4,742.

### **Deferred Taxes**

For the nine months ended September 30, 2016 and 2015, the change in deferred taxes was fully offset by a valuation allowance, resulting in a \$-0- net income tax provision.

## Net Loss

For the nine months ended September 30, 2016, we incurred a net loss of (\$7,851,365) or (\$0.00) per share, as compared with net loss of (\$9,283,122) or (\$0.01) per share for the nine months ended September 30, 2015. Included in the net loss for the nine months ended September 30, 2016 and 2015 was \$6,939,655 and \$8,203,376, respectively, of non-cash expenses, net of non-cash revenues.

## Liquidity and Capital Resources

Our cash position at September 30, 2016 was \$11,411, a decrease of (\$17,796) from the cash position of \$29,207 at December 31, 2015. We had negative working capital of (\$4,905,447) at September 30, 2016 which represents an improvement in our working capital of \$570,511 compared to the (\$5,475,958) of negative working capital at December 31, 2015. Our current liabilities of \$5,169,536 at September 30, 2016, decreased by \$562,764 from \$5,732,300 at December 31, 2015. This net decrease primarily resulted from (i) a \$474,731 net decrease in the derivative liability related to convertible promissory notes, (ii) a \$346,279 decrease in the carrying amount of convertible notes, net of unamortized discount, (iii) repayment of the \$19,349 current portion of a finance lease obligation and (iv) a \$9,400 net decrease in promissory notes to related parties, partially offset by (v) a \$232,958 increase in deferred compensation payable and (vi) a \$54,037 increase in accounts payable and accrued liabilities.

Operating activities utilized cash of (\$449,121) for the nine months ended September 30, 2016, an improvement of (\$357,478) from the cash utilized for operating activities of (\$806,599) for the nine months ended September 30, 2015. Cash utilized by operating activities in the nine months ended September 30, 2016 resulted primarily from (i) a cash basis net loss of (\$911,709), after adding back (deducting) non-cash stock-based compensation expense of \$6,768,560, interest accrued, but not paid of \$506,042, a non-cash decrease in embedded derivative liabilities related to convertible notes of (\$474,731), a non-cash loss on conversion of convertible notes of \$124,962 depreciation and amortization of \$36,122, non-cash licensing revenues and other income of (\$26,743) and non-cash portion of research and development expenses of \$5,443 and (ii) changes in current assets and liabilities, including an increase in inventory of (\$28,528), a decrease in deferred offering costs and other assets of \$2,985, an increase of \$255,173 in accounts payable and accrued liabilities and an increase in deferred compensation payable of \$232,958.

Cash used in investing activities of \$11,493 for the nine months ended September 30, 2016, consisted of outlays for furniture.

Cash provided by financing activities for the nine months ended September 30, 2016, amounted to \$442,818. This was comprised of proceeds from issuances of promissory notes to related parties of \$162,443, issuances of convertible promissory notes aggregating \$154,000, issuances of common stock under an equity purchase agreement of \$150,000 and proceeds from issuances of common stock and warrants amounting to \$45,000, partially offset by principal repayments of (\$45,000) on a mortgage loan payable, repayments of promissory notes held by related parties of (\$15,000) and finance lease obligation payments amounting to (\$8,625).

## Going Concern

We have incurred net recurring losses since inception, amounting to (\$64,822,362) as of September 30, 2016 and had a stockholders' deficiency of (\$4,693,771). We will need to obtain additional working capital in order to continue to cover our ongoing cash expenses.

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



During 2016, we restricted variable costs to only those expenses that are necessary to perform activities related to efforts to negotiate sublicenses for distribution of our CSRV<sup>®</sup> products, raising working capital to enable us to commence limited production of our CSRV<sup>®</sup> system technology products, research and development and general administrative costs in support of such activities.

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

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

At September 30, 2016, current liabilities amounted to \$5,169,536, comprised of promissory notes due to related parties aggregating \$1,446,482, legal and professional fees of \$1,445,834, deferred compensation of \$1,155,102, accrued general and administrative expenses of \$350,107, accrued interest expense of \$165,805, a derivative liability related to convertible promissory notes of \$158,196, deposits of \$150,595, accrued research and development expenses of \$114,859, convertible promissory notes, net of unamortized discount of \$61,831, the current portion of license deposits of \$60,725 and the current portion of a mortgage loan amounting to \$60,000.

### Contractual Obligations and Commitments

The following table summarizes our contractual obligations and commitments at September 30, 2016:

	<u>Total</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
Promissory notes to related parties	\$ 1,446,482	\$ 1,446,482	\$ -	\$ -
Mortgage loan payable	1,343,158	60,000	60,000	1,223,158
Deferred compensation	1,155,102	1,155,102	-	-
Convertible promissory notes	123,844	49,844	74,000	-
Total	<u>\$ 4,068,586</u>	<u>\$ 2,711,428</u>	<u>\$ 134,000</u>	<u>\$ 1,223,158</u>

### Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

### Critical Accounting Policies

The Company's significant accounting policies are presented in the Company's notes to financial statements for the period ended September 30, 2016, which are contained in this filing and notes to financial statements for the year ended December 31, 2015 which are contained in the Company's 2015 Annual Report on Form 10-K. The significant accounting policies that are most critical and aid in fully understanding and evaluating the reported financial results include the following:

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

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

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

## **New Accounting Pronouncements**

### *Revenue Recognition*

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"), which amends the existing accounting standards for revenue recognition. ASU 2014-09 is based on principles that govern the recognition of revenue at an amount an entity expects to be entitled to when products are transferred to customers. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606) – Deferral of the Effective Date, which defers the effective date of ASU 2014-09 for one year and permits early adoption as early as the original effective date. Accordingly, the Company may adopt the standard in either its first quarter of 2018 or 2019.

In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606) – Identifying Performance Obligations and Licensing ("ASU 2016-10"), which amends the guidance in ASU 2014-09 related to identifying performance obligations and accounting for licenses of intellectual property. The Company will adopt ASU 2016-10 with ASU 2014-09. The Company is currently evaluating the impact of adopting the new revenue recognition standard, as amended, but does not expect it to have a material impact on its financial statements.

### *Stock Compensation*

In March 2016, the FASB issued ASU No. 2016-09, Compensation – Stock Compensation (Topic 718) ("ASU 2016-09"), which simplified certain aspects of the accounting for share-based payment transactions, including income taxes, classification of awards and classification in the statement of cash flows. ASU 2016-09 will be effective for the Company beginning in its first quarter of 2018. The Company is currently evaluating the impact of adopting the new stock compensation standard, but does not expect it to have a material impact on its financial statements.

### *Financial Instruments*

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments – Overall (Subtopic 825-10) (“ASU 2016-01”), which updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments. ASU 2016-01 will be effective for the Company beginning in its first quarter of 2019. The Company does not believe the adoption of the new financial instruments standard will have a material impact on its financial statements.

### *Inventory Measurement*

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

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We are not required to provide the information under this item as we are a smaller reporting company.

### **Item 4. Controls and Procedures**

#### **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.

#### **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**

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

### **Item 1A. Risk Factors**

We believe there are no changes that constitute material changes from the risk factors previously disclosed in the Company's 2015 Annual Report on Form 10-K filed April 14, 2016.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

*The following issuances of securities during the nine months ended September 30, 2016 were exempt from registration pursuant to Section 4(2), and Regulation D promulgated under the Securities Act. We made this determination based on the representations of the Investors which included, in pertinent part, that such Investors were "accredited investors" within the meaning of Rule 501 of Regulation D promulgated under the Securities Act, and that such Investors were acquiring our common stock for investment purposes for their own respective accounts and not as nominees or agents, and not with a view to the resale or distribution thereof, and that the Investors understood that the shares of our common stock may not be sold or otherwise disposed of without registration under the Securities Act or an applicable exemption therefrom.*

In a series of transactions, during the nine months ended September 30, 2016, we issued \$165,000 of convertible promissory notes to various accredited investors and, after transaction costs, received net proceeds of \$154,000. The nominal interest rate on these notes ranged from 9.75% to 10%. These notes are generally convertible into unregistered shares of our common stock at any time beginning six months after issuance, with the exception of \$25,000 principal amount which qualified for immediate conversion on the date of issuance. These convertible notes provide for conversion rates at discounts from the trading price of our common stock over a defined number of trading days leading up to the date of conversion (the "Market Price"). The discounts ranged from 30% to 38% of the Market Price.

In a series of transactions, during the nine months ended September 30, 2016, an aggregate of \$664,546 principal amount of convertible promissory notes, including accrued interest was converted by the holders into 1,209,182,017 unregistered shares of our common stock.

In a series of transactions, during the nine months ended September 30, 2016, we made private sales, pursuant to stock purchase agreements of 55,000,000 unregistered shares of our common stock and 55,000,000 common stock warrants to purchase one unregistered share of our common stock at an exercise price of \$0.001 per share, in consideration for \$45,000.

In a series of transactions, during the nine months ended September 30, 2016, \$471,594 principal amount of promissory notes due to George J. Coates, including accrued interest, were converted into 570,456,147 unregistered, restricted shares of our common stock at conversion rates ranging from \$0.0006 to \$0.0011 per share, which was the closing trading price of the stock on the respective dates of conversion.

Net proceeds from the above transactions were used for general working capital purposes.

### **Item 3. Defaults upon Senior Securities**

None.

### **Item 4. Mine Safety Disclosures**

Not Applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

<b>Exhibit Number</b>	<b>Description</b>
10.1	Convertible Promissory Note Issued to APG Capital Holding, LLC dated September 28, 2016
10.2	Securities Purchase Agreement Between the Company and APG Capital Holding, LLC, dated September 28, 2016
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer 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.DE	XBRL Taxonomy Extension Definition Linkbase Document

In accordance with SEC Release 33-8238, Exhibit 32.1 and 32.2 are being furnished and not filed.

**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 10, 2016

/s/ George J. Coates

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

Date: November 10, 2016

/s/ Barry C. Kaye

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

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

**US \$33,000.00**

COATES INTERNATIONAL, LTD.  
10% CONVERTIBLE REDEEMABLE NOTE  
DUE SEPTEMBER 28, 2017

FOR VALUE RECEIVED, Coates International, Ltd. (the "Company") promises to pay to the order of APG CAPITAL HOLDINGS, LLC and its authorized successors and Permitted Assigns, defined below, ("Holder"), the aggregate principal face amount of Thirty Three Thousand Dollars exactly (U.S. \$33,000.00) on September 28, 2017 ("Maturity Date") and to pay interest on the principal amount outstanding hereunder at the rate of 10% per annum commencing on September 28, 2016. The interest will be paid to the Holder in whose name this Note is registered on the records of the Company regarding registration and transfers of this Note. The principal of, and interest on, this Note are payable at 300 Cadman Plaza West, 12th Floor, Brooklyn, NY 11201, initially, and if changed, last appearing on the records of the Company as designated in writing by the Holder hereof from time to time. The Company will pay each interest payment and the outstanding principal due upon this Note before or on the Maturity Date, less any amounts required by law to be deducted or withheld, to the Holder of this Note by check or wire transfer addressed to such Holder at the last address appearing on the records of the Company. The forwarding of such check or wire transfer shall constitute a payment of outstanding principal hereunder and shall satisfy and discharge the liability for principal on this Note to the extent of the sum represented by such check or wire transfer. Interest shall be payable in Common Stock (as defined below) pursuant to paragraph 4(b) herein. Permitted Assigns means any Holder assignment, transfer or sale of all or a portion of this Note accompanied by an Opinion of Counsel as provided for in Section 2(f) of the Securities Purchase Agreement.

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This Note is subject to the following additional provisions:

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

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

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

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



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

(c) During the first 180 days this Note is in effect, the Company may redeem this Note by paying to the Holder an amount equal to 150% of the face amount plus any accrued interest. This Note may not be prepaid after the 180<sup>th</sup> day anniversary. The redemption must be closed and paid for within 3 business days of the Company sending the redemption demand or the redemption will be invalid and the Company may not redeem this Note.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(j) Intentionally Deleted;

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

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

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

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

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

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

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

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

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

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

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

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

12. The Company shall internally reserve 304,147,000 shares of its Common Stock for conversions under this Note (the "Share Reserve"). Upon full conversion of this Note, any shares remaining in the Share Reserve shall be cancelled. The Company shall pay all transfer agent costs associated with issuing and delivering the share certificates to Holder. If such amounts are to be paid by the Holder, it may deduct such amounts from the Conversion Price. The company should at all times reserve a minimum of four times the amount of shares required if the note would be fully converted. The Holder may reasonably request increases from time to time to reserve such amounts. The Company will instruct its transfer agent to provide the outstanding share information to the Holder in connection with its conversions.

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

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

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

Dated: September 28, 2016

COATES INTERNATIONAL, LTD.

By: /s/ Barry C. Kaye

Barry C. Kaye  
Chief Financial Officer

**EXHIBIT A**

NOTICE OF CONVERSION

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

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

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

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

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

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

[Print Name of Holder and Title of Signer]

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

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

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

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

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

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

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

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

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

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

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

## SECURITIES PURCHASE AGREEMENT

This **SECURITIES PURCHASE AGREEMENT** (the “Agreement”), dated as of September 28, 2016, by and between **Coates International, Ltd.**, a Delaware corporation, with headquarters located at Highway 34 & Ridgewood Road, Wall Township, NJ 07719, (the “Company”), and **APG CAPITAL HOLDINGS, LLC**, a New York limited liability company, with its address at 300 Cadman Plaza West, 12<sup>th</sup> Floor, Brooklyn, NY 11201 (the “Buyer”).

**WHEREAS:**

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

B. Buyer desires to purchase and the Company desires to issue and sell, upon the terms and conditions set forth in this Agreement two 10% convertible notes of the Company, in the forms attached hereto as Exhibit A and B in the aggregate principal amount of \$66,000.00 (with the first note being in the amount of \$33,000.00 and the second note being in the amount of \$33,000.00 (together with any note(s) issued in replacement thereof or as a dividend thereon or otherwise with respect thereto in accordance with the terms thereof, the “Note”), convertible into shares of common stock of the Company (the “Common Stock”), upon the terms and subject to the limitations and conditions set forth in such Note. The first of the two notes shall be paid for by the Buyer as set forth herein. The second note (the “Second Note”) shall initially be paid for by the issuance of an offsetting \$33,000.00 secured note issued to the Company by the Buyer (“Buyer Note”), provided that prior to conversion of the Second Note, the Buyer must have paid off the Buyer Note in cash such that the Second Note may not be converted until it has been paid for in cash.

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

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

1. Purchase and Sale of Note.

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

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

c. Closing Date. The date and time of the first issuance and sale of the Note pursuant to this Agreement (the "Closing Date") shall be on or about September 28, 2016, or such other mutually agreed upon time. The closing of the transactions contemplated by this Agreement (the "Closing") shall occur on the Closing Date at such location as may be agreed to by the parties. Subsequent Closings shall occur when the Buyer Note is repaid. The Closing of the Second Note shall be on or before the dates specified in the Buyer Note. The Company may reject the closing of the back end financing by giving the Buyer written notice at least 30 days prior to the 6 month anniversary of the Second Note of its intent to reject the funding of the Second Note. In such case both the Buyer Note and the Second Note shall be terminated.

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

i. Title to Property. The Company and its subsidiaries have good and marketable title in fee simple to all real property and good and marketable title to all personal property owned by them which is material to the business of the Company and its subsidiaries, in each case free and clear of all liens, encumbrances and defects except such as would not have a material adverse effect. Any real property and facilities held under lease by the Company and its subsidiaries are held by them under valid, subsisting and enforceable leases with such exceptions as would not have a material adverse effect.

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

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

#### 4. COVENANTS.

a. Expenses. At the Closing, the Company shall reimburse Buyer for no more than \$2,000.00 of expenses incurred by them in connection with the negotiation, preparation, execution, delivery and performance of this Agreement and the other agreements to be executed in connection herewith ("Documents"), including, without limitation, reasonable attorneys' and consultants' fees and expenses, transfer agent fees, fees for stock quotation services, fees relating to any amendments or modifications of the Documents or any consents or waivers of provisions in the Documents, fees for the preparation of opinions of counsel, escrow fees, and costs of restructuring the transactions contemplated by the Documents. When possible, the Company must pay these fees directly, otherwise the Company must make immediate payment for reimbursement to the Buyer for all fees and expenses immediately upon written notice by the Buyer or the submission of an invoice by the Buyer. The Company shall also be responsible for all costs, other than share issuance taxes, if any, relating to the issuance of the shares issuable upon conversion of the Note.

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

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

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

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

5. Governing Law; Miscellaneous.

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

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

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

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

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

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

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

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

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

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

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

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



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

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

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

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

**Coates International, Ltd.**

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

**APG CAPITAL HOLDINGS, LLC.**

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

**AGGREGATE SUBSCRIPTION AMOUNT:**

Aggregate Principal Amount of Note: \$66,000.00

Aggregate Purchase Price:

Note 1: \$33,000.00 less \$2,000.00 in legal fees

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

**CERTIFICATION 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 10, 2016

/s/ George J. Coates

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

**CERTIFICATION 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 10, 2016

/s/ Barry C. Kaye

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

**CERTIFICATION PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)**

In connection with the Quarterly Report of Coates International, Ltd. (the "Company") on Form 10-Q for the period ended September 30, 2016 (the "Report"), I, George J. Coates, 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 10, 2016

*/s/ George J. Coates*

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

**CERTIFICATION PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)**

In connection with the Quarterly Report of Coates International, Ltd. (the "Company") on Form 10-Q for the period ended September 30, 2016 (the "Report"), I, Barry C. Kaye, 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 10, 2016

*/s/ Barry C. Kaye*

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