

**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 **March 31, 2013**

OR

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

For the transition period from _____ to _____



Commission File Number: 000-33155

COATES INTERNATIONAL, LTD.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

22-2925432

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

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

(Address of principal executive offices) (Zip Code)

N/A

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

(732) 449-7717

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>	Non-accelerated filer	<input type="checkbox"/>
Non-accelerated filer (Do not check if a smaller reporting company)	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>		<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 May 8, 2013, 339,434,756 shares of the Registrant's common stock, par value \$0.0001 per share were issued and outstanding.

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

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	<u>March 31,</u> <u>2013</u>	<u>December 31,</u> <u>2012</u>
	(Unaudited)	
Assets		
Current Assets		
Cash	\$ 17,072	\$ 13,303
Inventory, net	111,115	111,115
Deferred offering costs	14,137	16,207
Total Current Assets	<u>142,324</u>	<u>140,625</u>
Property, plant and equipment, net	2,226,297	2,241,847
Deferred licensing costs, net	54,228	55,299
Total Assets	<u>\$ 2,422,849</u>	<u>\$ 2,437,771</u>
Liabilities and Stockholders' Deficiency		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 1,952,051	\$ 1,797,439
Mortgage loan payable	1,560,000	1,575,000
Promissory notes to related parties	610,023	507,694
Deferred compensation payable	200,334	1,911,775
Convertible promissory notes, net of unamortized discount	28,330	77,363
Derivative liability related to convertible promissory notes	207,480	135,263
Unearned revenue	19,124	19,124
10% Convertible note	10,000	10,000
Total Current Liabilities	<u>4,587,342</u>	<u>6,033,658</u>
License deposits	336,600	341,400
Total Liabilities	<u>4,923,942</u>	<u>6,375,058</u>
Commitments and Contingencies		
Stockholders' Deficiency		
Preferred Stock, \$0.001 par value, 100,000,000 shares authorized, 72,883 and 72,883 shares issued and outstanding at March 31, 2013 and December 31, 2012, respectively	73	73
Common Stock, \$0.0001 par value, 1,000,000,000 shares authorized, 339,384,756 and 305,078,818 shares issued and outstanding at March 31, 2013 and December 31, 2012, respectively	33,938	30,508
Additional paid-in capital	29,497,865	27,259,253
Accumulated deficit	<u>(32,032,969)</u>	<u>(31,227,121)</u>
Total Stockholders' Deficiency	<u>(2,501,093)</u>	<u>(3,937,287)</u>
Total Liabilities and Stockholders' Deficiency	<u>\$ 2,422,849</u>	<u>\$ 2,437,771</u>

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

Coates International, Ltd. and Subsidiaries
Consolidated Statements of Operations
Unaudited

	For the Three Months Ended March 31,	
	2013	2012
Sublicensing fee revenue	\$ 4,800	\$ 4,800
Expenses:		
Research and development costs	-	186,066
General and administrative expenses	623,612	1,054,776
Depreciation and amortization	16,621	15,068
Total Expenses	<u>640,233</u>	<u>1,255,910</u>
Loss from Operations	<u>(635,433)</u>	<u>(1,251,110)</u>
Other Income (Expense):		
(Increase) decrease in estimated fair value of embedded derivative liabilities	(70,414)	28,592
Interest expense	<u>(100,001)</u>	<u>(176,767)</u>
Total other income (expense)	<u>(170,415)</u>	<u>(148,175)</u>
Loss Before Income Taxes	(805,848)	(1,399,285)
Provision for income taxes	-	-
Net Loss	<u>\$ (805,848)</u>	<u>\$ (1,399,285)</u>
Basic net loss per share	<u>\$ -</u>	<u>\$ -</u>
Basic weighted average shares outstanding	<u>328,516,041</u>	<u>287,565,082</u>
Diluted net loss per share	<u>\$ -</u>	<u>\$ -</u>
Diluted weighted average shares outstanding	<u>328,516,041</u>	<u>287,565,082</u>

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

Coates International Ltd. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
Unaudited

	For the Three Month Ended March 31,	
	2013	2012
Net Cash (Used in) Operating Activities	\$ (188,601)	\$ (361,766)
Net Cash Provided by (Used in) Investing Activities	-	-
Cash Flows Provided by (Used in) Financing Activities:		
Issuance of common stock and warrants	35,000	250,143
Issuance of common stock under equity line of credit	3,041	-
Issuance of convertible promissory note	67,000	52,000
Issuance of promissory notes to related parties	125,329	42,600
Repayment of promissory notes to related party	(23,000)	(25,000)
Repayment of Mortgage Loan	(15,000)	(10,000)
Net Cash Provided by Financing Activities	<u>192,370</u>	<u>309,743</u>
Net Increase (Decrease) in Cash	3,769	(52,023)
Cash, beginning of period	13,303	52,955
Cash, end of period	<u>\$ 17,072</u>	<u>\$ 932</u>
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for interest	<u>\$ 29,452</u>	<u>\$ 20,349</u>
Supplemental Disclosure of Non-cash Financing Activities:		
Deferred compensation payable paid with common stock	\$ 1,761,175	\$ -
Conversion of convertible promissory notes	92,200	135,720
	<u>\$ 1,853,375</u>	<u>\$ 135,720</u>

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

Coates International, Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
For the Three Months Ended March 31, 2013 and 2012
(All amounts rounded to thousands of dollars)
(Unaudited)

1. BASIS OF PRESENTATION

Basis of Presentation

The accompanying unaudited consolidated financial statements of Coates International, Ltd. and its majority-owned subsidiaries (the "Company") have been prepared in accordance with accounting principles generally accepted for interim financial information and rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, they do not include all of the information and notes required by generally accepted accounting principles in the United States ("GAAP") for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for the three months ended March 31, 2013 and 2012 are not necessarily indicative of the results that may be expected for any other interim period or for the full year. The unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2012.

Going Concern

As shown in the accompanying consolidated financial statements, the Company has incurred recurring losses from operations and, as of March 31, 2013, had a stockholders' deficiency of (\$2,501,000). The Company will be required to negotiate the terms of an extension of a \$1,560,000 mortgage loan which matures in July 2013, or successfully refinance the property with another lender, if possible. Failure to do so could adversely affect the Company's financial position and results of operations. 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. The financial statements do not include any adjustments that might be necessary should the Company become unable 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 carry out the Company's activities related to entering the production phase of operations, develop additional commercially feasible applications of the CSRV system technology, seek additional sources of working capital and cover general and administrative costs in support of such activities. The Company continues to actively undertake efforts to secure new sources of working capital. At the March 31, 2013, the Company had negative working capital of (\$4,445,000) compared with negative working capital of (\$5,893,000) at December 31, 2012.

2. ACCOUNTING POLICIES

Principles of Consolidation

The financial statements of the Company were consolidated with the accounts of Coates Hi-Tech Engines, Ltd. ("Coates Hi-Tech"), a majority-owned subsidiary since July 2012 and Coates Oklahoma Engine Manufacturing, Ltd. ("Coates Oklahoma"), a majority-owned subsidiary since August 2011. Neither of these companies had commenced operations at March 31, 2013. All significant intercompany transactions and accounts were eliminated in consolidation.

Loss per Share

Basic net loss per share is based on the weighted average number of common shares outstanding without consideration of potentially dilutive shares of common stock. There were no shares of preferred stock outstanding with rights to share in the Company's net income during the three month periods ended March 31, 2013 and 2012. Diluted net income per share is based on the weighted average number of common and potentially dilutive common shares outstanding, when applicable.

Use of Estimates

The preparation of the Company's consolidated 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, 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.

3. CONCENTRATIONS OF CREDIT AND BUSINESS RISK

The Company maintains cash balances with one financial institution. Accounts at this institution are currently fully insured by the Federal Deposit Insurance Corporation.

The Company's operations are devoted to the development, application and marketing of the CSRV system technology which was invented by George J. Coates, the Company's founder, Chairman, Chief Executive Officer, President and controlling stockholder. Development efforts have been conducted continuously during this time. From July 1982 through May 1993, seven U.S. patents as well as a number of foreign patents were issued with respect to the CSRV 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.

The Company is highly dependent on Almont Energy Inc. ("Almont") for cash flows, revenues and profits. Almont is the successor in interest under agreements with the Company including (i) a research and development agreement and an exclusive sub-licensing agreement covering the sale and distribution of natural gas fueled, industrial electric power CSRV engine generators ("Gen Sets") for use in the generation of electrical power within the territory of Canada, and; (ii) the rights, subject to the provisions of a related escrow agreement, to an exclusive sub-licensing agreement covering the sale and distribution of Gen Sets for use in the generation of electrical power within the territory of the United States (the "Almont Agreements"). At March 31, 2013, Almont was obligated to the Company under the Almont Agreements for \$5,847,000. In addition, Almont is also obligated to remit an additional \$49 million toward the licensing fee provided for under the US License Agreement. It is not likely that Almont will be able to make additional payments of the amounts due to the Company until the Company can raise sufficient new working capital to commence production and shipment of Gen Sets to Almont.

4. LICENSING AGREEMENT AND DEFERRED LICENSING COSTS

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

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

At March 31, 2013, deferred licensing costs, comprised of expenditures for patent costs incurred pursuant to the CSRV licensing agreement, net of accumulated amortization, amounted to \$54,000. Amortization expense for the three months ended March 31, 2013 and 2012 amounted to \$1,000 and \$1,000, respectively.

5. AGREEMENTS ASSIGNED TO ALMONT ENERGY INC.

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

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

The Escrow Agreement requires that Almont, as the assignee, make a payment (“Release Payment”) to the Company equal to the then remaining unpaid balance of the Canadian License licensing fee, the R&D Agreement fee and the down payment of \$1,000,000 required under the US License. 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 shipment of Gen Sets to Almont. At March 31, 2013, the remaining balance of the Release Payment was \$5,847,000.

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

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

The inability of Almont to make additional payments towards the balance of the Release Payment at this time, is having and adverse affect on the Company's cash flow, results of operations and financial condition.

The Canadian License

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

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

The US License

The US License will, upon Almont satisfying the Release Payment, grant to Almont the right to use, sell and lease within the defined territory, Licensed Products manufactured by the Company which are designed to generate electrical power. Licensed Products consist of CSRV Valve Systems, CSRV Valve Seals, CSRV Rotary Valve Spheres, CSRV Valve Components and CSRV Engines. Almont is also obligated to pay a royalty to the Company equal to 2.5% of its annual modified gross profit (which has been defined as sales, less cost of sales, plus \$400,000).

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

The business plan of Almont, which is highly dependent on its ability to raise sufficient additional working capital, is based on its projected assessment of the marketplace demand for industrial generators of various sizes and kilowatt output. Almont projects Gen Set purchases of up to 11,000 CSRV Units per year over the next 5 years. The Company would not be able to accommodate that demand until it ramps up its production capacity, which would likely require several years, once it enters into large scale production. Almont intends to issue standard purchase orders, issued based on market and customer demand. The Company is unable to confirm any orders until we have sufficient working capital in place to manufacture generators on a larger scale. Almont plans to finance its purchases from cash flow and by way of project and/or equipment financing, proceeds from issuance of equity or corporate debt instruments and conventional bank financing.

6. COOPERATION AGREEMENT WITH TONGJI UNIVERSITY OF CHINA

The Company and the Coates Trust (collectively “Coates”) entered into a Cooperation Agreement with Tongji University of China (the “University”) for the purpose of enabling the University to undertake an evaluation and testing of the CSRV engine technology. The results of the evaluation and testing would be used to determine if, and to what extent, the engine technology could be applied in the manufacture and distribution of products in China. At this time, the parties are not actively working on this cooperation agreement, but may agree to do so at some point in the future.

7. INVESTMENT IN MAJORITY-OWNED SUBSIDIARIES

Coates Hi-Tech was formed in 2012 for the purpose of applying for a package of business, finance and tax benefit incentives in one or more states. The Company holds an approximately 66% interest in this company. Certain states generally will offer such incentives to companies as an inducement to establish manufacturing operations in their state, resulting in a stimulus to the state economy and the creation of new jobs. Should the Company decide to locate its manufacturing operations in one or more of these states, it would be required to raise substantial new working capital to carry out this undertaking.

Coates Oklahoma was formed in 2011 for the purpose of applying for a package of business, finance and tax benefit incentives. The Company holds an approximately 66% interest in this company. Oklahoma generally will offer such incentives to companies as an inducement to establish manufacturing operations in Oklahoma, resulting in a stimulus to the state economy and the creation of new jobs. Should the Company decide to locate its manufacturing operations in Oklahoma, it would be required to raise substantial new working capital to carry out this undertaking.

8. LICENSE DEPOSITS

License deposits, which are non-refundable, primarily relate to a \$300,000 sublicense deposit received in prior years as a down payment on the Canadian License. This sublicense deposit is being recognized as revenue on a straight-line basis over the remaining life until 2027 of the last CSRV technology patent in force, at that date. Sublicensing fee revenue for the three months ended March 31, 2013 and 2012 amounted to \$5,000 and \$5,000, respectively.

9. INVENTORY

Inventory was comprised of the following:

	March 31, 2013	December 31, 2012
Raw materials	\$ 439,000	\$ 439,000
Work-in-process	59,000	59,000
Finished goods	-	-
Reserve for obsolescence	(387,000)	(387,000)
Total	<u>\$ 111,000</u>	<u>\$ 111,000</u>

10. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment were comprised of the following:

	<u>March 31,</u> <u>2013</u>	<u>December 31,</u> <u>2012</u>
Land	\$ 1,235,000	\$ 1,235,000
Building	964,000	964,000
Building improvements	83,000	83,000
Machinery and equipment	658,000	658,000
Furniture and fixtures	39,000	39,000
	<u>2,979,000</u>	<u>2,979,000</u>
Less: Accumulated depreciation	<u>(753,000)</u>	<u>(737,000)</u>
Total	<u>\$ 2,226,000</u>	<u>\$ 2,242,000</u>

Depreciation expense for the three months ended March 31, 2013 and 2012 was \$16,000 and \$14,000, respectively.

11. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consisted of the following:

	<u>March 31,</u> <u>2013</u>	<u>December 31,</u> <u>2012</u>
Legal and professional fees	\$ 1,297,000	\$ 1,240,000
Accrued compensation and benefits	181,000	175,000
General and administrative expenses	213,000	149,000
Accrued interest payable	146,000	118,000
Research and development	115,000	115,000
Total	<u>\$ 1,952,000</u>	<u>\$ 1,797,000</u>

12. MORTGAGE LOAN PAYABLE

The Company has a mortgage loan on the land and building that serves as its headquarters and research and development facility which bears interest at the rate of 7.5% per annum and which matures in July 2013. Interest expense for the three months ended March 31, 2013 and 2012 on this mortgage amounted to \$30,000 and \$31,000, respectively. The loan requires monthly payments of interest, plus \$5,000 which is being applied to the principal balance. The remaining principal balance at March 31, 2013 was \$1,560,000. The Company will be required to negotiate the terms of a further extension of the mortgage loan or successfully refinance the property with another mortgage lender, if possible. Failure to do so could adversely affect the Company's financial position and results of operations.

The loan is collateralized by a security interest in all of the Company's assets, the pledge of five million shares of common stock of the Company owned by George J. Coates, which were deposited into escrow for the benefit of the lender and the personal guarantee of George J. Coates. The Company is not permitted to create or permit any secondary mortgage or similar liens on the property or improvements thereon without prior consent of the lender. Up to \$500,000 of the principal balance of the mortgage loan may be prepaid each year without penalty. A prepayment penalty of 2% of the outstanding loan amount would be imposed if the loan is repaid in full at or before maturity unless such prepayment funds are obtained from a permanent mortgage loan with the lender.

13. PROMISSORY NOTES TO RELATED PARTIES

During the three months ended March 31, 2013 and 2012, the Company issued, in a series of transactions, promissory notes to George J. Coates and received cash proceeds of \$82,000 and \$42,000, respectively, and repaid promissory notes in the aggregate principal amount of \$17,000 and \$25,000, respectively, bringing the outstanding balance at March 31, 2013 to \$507,000. The promissory notes are payable on demand and provide for interest at the rate of 17% per annum, compounded monthly.

During the three months ended March 31, 2013, the Company issued, in a series of transactions, promissory notes to Bernadette Coates, spouse of George J. Coates and received cash proceeds of \$43,000 and repaid promissory notes in the aggregate principal amount of \$7,000, bringing the outstanding balance at March 31, 2013 to \$102,000. There were no notes issued or repaid during the three months ended March 31, 2012. The promissory notes are payable on demand and provide for interest at the rate of 17% per annum, compounded monthly.

During the three months ended March 31, 2012, the Company had outstanding promissory notes with two of its directors, Dr. Richard W. Evans and Dr. Frank J. Adipietro with principal balances of \$120,000 and \$50,000, respectively. These promissory notes were payable on demand and provided for interest at the rate of 17% per annum, compounded monthly.

For the three months ended March 31, 2013 and 2012, aggregate interest expense on all of these promissory notes amounted to \$30,000 and \$22,000, respectively. Unpaid accrued interest on these promissory notes amounting to \$125,000 is included in accounts payable and accrued liabilities in the accompanying consolidated balance sheet at March 31, 2013.

14. CONVERTIBLE PROMISSORY NOTES AND EMBEDDED DERIVATIVE LIABILITIES

From time to time, the Company issues convertible promissory notes. The net proceeds from these transactions are used for general working capital purposes. The conversion formula for these notes meets the conditions that require accounting for these notes as derivative liability instruments.

8% Convertible Promissory Note

The 8% convertible promissory note (8% Note²) in the principal amount of \$33,000 matures in August 2013, in not converted prior thereto. It may be converted into unregistered shares of the Company's common stock, par value \$0.0001 per share (the "Common Stock"), at the Conversion Price, as defined below, in whole, or in part, at any time beginning 180 days after the date of issuance of the Note, at the option of the holder. The Conversion Price shall be equal to 61% multiplied by the Variable Conversion Rate which is equal to the average of the three (3) lowest closing bid prices of the Common Stock during the ten (10) trading day period prior to the date of conversion. The 8% Note also contains a prepayment option whereby the Company may, during the first 179 days the note is outstanding, prepay the 8% Note by paying 130% during the first 60 days, increasing in 5% increments each month to a maximum of 150% of the then outstanding unpaid principal, interest and any other amounts that might be due for penalties or any event of a default.

The 61% discounted Conversion Price 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 8% Note into common stock is permitted. The Company has reserved 4.1 million shares of its unissued common stock for potential conversion of this 8% Note.

12% Convertible Promissory Note

The Company has also entered into an agreement whereby it is permitted to issue in a series of tranches up to \$335,000 of convertible promissory notes which bear interest at 12% per annum and mature on the one-year anniversary of the notes ("12% Notes"). In March 2013, the Company issued a \$67,000 12% Note under this arrangement and received cash proceeds of \$60,000. This note matures in March 2014, if not converted prior thereto. The arrangement provides for an approximately 10.5% original issue discount on the principal amount of each tranche, which is netted against the amount funded to the Company. The promissory note may be prepaid at any time within the first 90 days, upon which the interest for the outstanding period will be forgiven. The lender may convert the 12% Notes into shares of the Company's common stock at any time beginning 180 days after the date of funding. The conversion rate shall be equal to the lesser of \$0.035 per share or 60% of the lowest trade price of the Company's common stock in the 25 trading days prior to the date of conversion. The Company has reserved 35 million shares of its unissued common stock for potential conversion of this 12% Note agreement.

In accordance with GAAP, the estimated fair value of the embedded derivative liability related to the 8% Notes and 12% Notes is required to be remeasured at each balance sheet date. 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.

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 lower Conversion Rate than the closing price of the stock on the actual date of conversion (hereinafter referred to as the "Variable Conversion Rate Differential". The estimated fair values of the derivative liabilities have been calculated based on a Black-Scholes option pricing model.

The following table presents the details of the outstanding 8% Notes and 12% Notes at March 31, 2013 and December 31, 2012, including the balance of the unamortized discount and the amount of the embedded derivative liability:

<u>Date Issued</u>	<u>Principal Amount</u>		<u>Nominal Interest Rate</u>	<u>Effective Interest Rate ⁽¹⁾</u>	<u>Unamortized Discount</u>		<u>Embedded Derivative Liability</u>	
	<u>March 31, 2013</u>	<u>December 31, 2012</u>			<u>March 31, 2013</u>	<u>December 31, 2012</u>	<u>March 31, 2013</u>	<u>December 31, 2012</u>
3/21/13	\$ 67,000	\$ -	12%	147%	\$ 64,000	\$ -	\$ 154,000	\$ -
11/23/12	33,000	33,000	8%	101%	7,000	17,000	54,000	41,000
9/24/12	-	32,000	8%	122%	-	14,000	-	41,000
8/6/12	-	43,000	8%	142%	-	12,000	-	53,000
6/12/12	-	12,000	8%	142%	-	-	-	-
	<u>\$ 100,000</u>	<u>\$ 120,000</u>			<u>\$ 71,000</u>	<u>\$ 43,000</u>	<u>\$ 208,000</u>	<u>\$ 135,000</u>

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

Other (expense) income resulting from the change in the estimated fair value of the embedded derivative liabilities amounted to (\$70,000) and \$29,000 for the three months ended March 31, 2013 and 2012, respectively. This amount is included in the accompanying statements of operations as change in embedded derivative liability. Interest expense resulting from accretion of the unamortized discount for the three months ended March 31, 2013 and 2012 amounted to \$38,000 and \$117,000, respectively.

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. 10% CONVERTIBLE NOTE TO RELATED PARTY

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

16. UNEARNED REVENUE

The Company has received a non-refundable deposit of \$19,000 from Almont in connection with its order for a natural gas fueled electric power CSRV engine generator, which is included in unearned revenue in the accompanying consolidated balance sheet at March 31, 2013 and December 31, 2012.

17. CONTRACTUAL OBLIGATIONS

The following table summarizes the Company's contractual obligations at March 31, 2013:

	<u>Total</u>	<u>Due Within</u>	
		<u>2013</u>	<u>2014</u>
Mortgage loan payable	\$ 1,560,000	\$ 1,560,000	\$ -
Promissory notes to related parties	610,000	610,000	-
Deferred compensation	200,000	200,000	-
Convertible promissory notes	100,000	33,000	67,000
10% promissory note	10,000	10,000	-
Total	<u>\$ 2,480,000</u>	<u>\$ 2,413,000</u>	<u>\$ 67,000</u>

18. CAPITAL STOCK

Common Stock and Anti-dilution Rights

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

The following transactions occurred during the three months ended March 31, 2013:

In a series of transactions during 2013, the Company made private sales, pursuant to stock purchase agreements of 999,999 unregistered shares of its common stock and 2,000,001 common stock warrants to purchase one share of our common stock at an exercise price of \$0.035 per share in consideration for \$35,000 received from the son of Richard W. Evans, a director.

In a series of transactions, the Company issued 6,705,446 unregistered shares of its common stock to George J. Coates for anti-dilution protection related to new shares of common stock issued in 2013. The estimated value of these shares, based on the closing trading price of the stock on the dates of the issuances was \$203,000.

In connection with an agreement to issue up to \$335,000 convertible promissory notes, in March 2013, the Company issued a \$67,000 principal amount convertible promissory note and received cash proceeds of \$60,000. The lender may convert the promissory note into unregistered shares of the Company's common stock at any time beginning 180 days after the date of funding. The conversion rate shall be equal to the lesser of \$0.035 per share or 60% of the lowest trading price of the common stock in the 25 trading days prior to the date of conversion. The Company has reserved 35 million shares of its unissued common stock for potential conversion under the \$335,000 convertible note agreement.

In a series of transactions during 2013, 8% convertible promissory notes with an aggregate principal balance of \$88,000, plus accrued interest of \$4,000 were converted into 5,705,447 unregistered shares of common stock.

In January 2013, the Company issued 20,895,046 unregistered shares of its common stock to George J. Coates in satisfaction of a deferred compensation liability consisting of 20,275,046 shares for anti-dilution protection for the year ended December 31, 2012 and a 620,000 share stock award originally granted in 2011. The value of these shares, based on the closing trading price on the dates of the anti-dilution or the date of the stock award was \$1,761,000, of which \$1,674,000 and \$87,000 was charged to stock compensation expense during the years ended December 31, 2012 and 2011, respectively.

At March 31, 2013, Company had reserved 33,568,786 shares of its common stock to cover the potential conversion of convertible securities and exercise of stock options and warrants.

Preferred Stock and anti-dilution rights

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

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

No new shares of Series A Preferred Stock were issued during the three months ended March 31, 2013 and 2012.

At March 31, 2013, George J. Coates held 72,883 shares of Series A Preferred Stock which provides him with the right to 728,830,000 aggregate additional votes on all matters brought before the shareholders for a vote.

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

19. INVESTMENT AGREEMENTS WITH DUTCHESS OPPORTUNITY FUND II, LP

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

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

In connection with the Investment Agreement, the Company also entered into a registration rights agreement (the “Registration Rights Agreement”) with Dutchess. Pursuant to the Registration Rights Agreement, the Company filed a registration statement on Form S-1 with the Securities and Exchange Commission (“SEC”), covering 17,500,000 shares of the common stock underlying the Investment Agreement. In addition, during the term of the Registration Rights Agreement, the Company is obligated to maintain the effectiveness of such registration statement.

During the three months ended March 31, 2013 and 2012, the Company sold 86,128 and 1,726,677 registered shares of its common stock, respectively, under this equity line of credit with Dutchess and received proceeds of \$3,000 and \$225,000, respectively, which were used for general working capital purposes. There were no offering costs related to the sale of these shares.

20. LOSS PER SHARE

For the three months ended March 31, 2013 and 2012, diluted net loss per share was based on the weighted average number of common shares outstanding without consideration of potentially dilutive shares of common stock because the Company incurred a net loss in those periods and the effect of including any of the potentially dilutive shares of common stock in the calculation would have been anti-dilutive.

The following presents the potentially issuable shares of common stock upon assumed conversion of:

Description	Exercise Price	Number of Underlying Shares of Common Stock at March 31,	
		2013	2012
Common stock options (1)	\$ 0.0600	5,607,000	-
Common stock options (2)	0.2400	1,800,000	1,800,000
Common stock options (3)	0.2500	2,000,000	2,000,000
Common stock options	0.3900	50,000	50,000
Common stock options	0.4000	360,000	360,000
Common stock options	0.4300	100,000	100,000
Common stock options	0.4400	1,750,000	1,750,000
Common stock options	1.0000	30,000	30,000
Common stock warrants	0.0350	2,000,001	-
Common stock warrants	0.0450	333,333	-
Common stock warrants	0.0500	400,000	-
Common stock warrants	0.0550	2,181,819	-
Common stock warrants	0.0600	2,000,000	-
Common stock warrants	0.0625	4,269,838	-
Common stock warrants	0.0700	571,529	-
Common stock warrants	0.0900	666,666	-
Common stock warrants	0.1200	416,667	-
Common stock warrants	0.2500	1,200,000	1,200,000
Common stock warrants	0.2700	833,333	833,333
Common stock warrants	0.3000	333,333	333,333
Common stock warrants	0.3250	153,846	153,846
Common stock warrants	0.3500	1,028,570	1,028,570
Common stock warrants	1.1000	-	210,000
\$10,000, 10% Convertible promissory note	0.4500	22,222	22,222
8% Convertible promissory notes	(4)	2,127,396	2,039,803
12% Convertible promissory notes	(5)	3,333,333	-
Total		33,568,786	11,911,107

(1) These unvested stock options will fully vest in June 2013.

- (2) Full vesting of these stock options occurred in August 2012.
- (3) Full vesting of these stock options occurred in March 2012 for 200,000 stock options and in July 2012 for 1,800,000 stock options.
- (4) The principal amount of the 8% convertible promissory note outstanding, which was not eligible for conversion at March 31, 2013, was \$33,000. The conversion rate is variable as it is equal to the average of the three lowest closing bid prices during the ten trading days prior to the date of conversion. The actual number of shares underlying these convertible instruments will likely vary from the number assumed above. The number of shares underlying these convertible notes was determined based on the three lowest closing bid prices during the ten trading days prior to March 29, 2013, the last trading day of the quarter.
- (5) The principal amount of the 12% convertible promissory note outstanding, which was not eligible for conversion at March 31, 2013, was \$67,000. The conversion rate is variable as it is equal to the lowest trading price during the twenty-five trading days prior to the date of conversion. The actual number of shares underlying these convertible instruments will likely vary from the number assumed above. The number of shares underlying these convertible notes was determined based on the lowest trading price during the twenty-five trading days prior to March 29, 2013, the last trading day of the quarter.

21. 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 ("incentive stock options") within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), options not intended to qualify as incentive stock options ("non-statutory options"), restricted stock and other stock-based awards. Incentive stock options may be granted only to employees of the Company. A total of 12,500,000 shares of common stock may be issued upon the exercise of options or other awards granted under the Stock Plan. The maximum number of shares with respect to which awards may be granted during any one year to any employee under the Stock Plan shall not exceed 25% of the 12,500,000 shares of common stock covered by the Stock Plan.

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

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

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

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

During the three months ended March 31, 2013 and 2012, no stock options were granted.

During the three months ended March 31, 2013, no stock options became vested. During the three months ended March 31, 2012, 200,000 stock options with an exercise price of \$0.25 per share became vested. The estimated fair value of 5,607,000 nonvested stock options at March 31, 2013 was \$358,000. Total compensation cost related to nonvested stock options at March 31, 2013 that had not been recognized was \$90,000. This non-cash compensation expense will be recognized in the future over a remaining weighted average period of approximately three months.

During the three months ended March 31, 2013 and 2012, the Company recorded non-cash stock-based compensation expense related to employee stock options amounting to \$90,000 and \$241,000, respectively. For the three months ended March 31, 2013 and 2012, \$-0- and \$88,000, respectively, of this amount is included in research and development expenses and \$90,000 and \$153,000, respectively, of this amount is included in general and administrative expenses in the accompanying consolidated statements of operations.

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

	<u>Exercise Price Per Share</u>	<u>Number Outstanding</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Number Exercisable</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Fair Value Per Stock Option at Date of Grant</u>
Balance, 3/31/13	\$ 0.06 -1.00	11,697,000	14	6,090,000	\$ 0.019	\$ 0.018

No stock options were exercised, forfeited or expired during the three months ended March 31, 2013.

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

Historical stock price volatility	139-180%
Risk-free interest rate	0.21%-4.64%
Expected life (in years)	4
Dividend yield	0.00%

The valuation assumptions were determined as follows:

- Historical stock price volatility: The Company initially obtained the volatility factor of other publicly traded engine manufacturers that were also in the research and development stage. Subsequently, once sufficient trading history became available, the volatility factor was calculated based on the historical daily closing prices of the Company's common stock on the OTCBB.
- Risk-free interest rate: The Company bases the risk-free interest rate on the interest rate payable on U.S. Treasury securities in effect at the time of the grant for a period that is commensurate with the assumed expected option life.
- Expected life: The expected life of the options represents the period of time options are expected to be outstanding. The Company has very limited historical data on which to base this estimate. Accordingly, the Company estimated the expected life based on its assumption that the executives will be subject to frequent black-out periods during the time that the stock options will be exercisable and based on the Company's expectation that it will complete its research and development phase and commence its initial production phase. The vesting period of these options was also considered in the determination of the expected life of each stock option grant.
- No expected dividends.

The same methodology and assumptions were utilized in estimating the fair value of non-employee stock options granted to the Company's general corporate counsel, as discussed above.

22. INCOME TAXES

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

Deferred tax assets increased by \$255,000 and \$617,000 for the three months ended March 31, 2013 and 2012, respectively. These amounts were fully offset by a corresponding decrease in the tax valuation allowance resulting in no net change in deferred tax assets, respectively, during these periods.

No liability for unrecognized tax benefits was required to be reported at March 31, 2013 and 2012. 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 2009 through 2012, 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 three months ended March 31, 2013 and 2012, there were no penalties or interest related to the Company's income tax returns.

23. RELATED PARTY TRANSACTIONS

Compensation and Benefits Paid

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

	For the Three Months Ended March 31,	
	2013	2012 (a)
George J. Coates (b), (c)	\$ 29,000	\$ 73,000
Gregory Coates	45,000	45,000
Bernadette Coates (d)	13,000	21,000

- (a) Certain amounts for the three months ended March 31, 2012 were reclassified in order to make them comparable to the amounts for the three months ended March 31, 2013.
- (b) For the three months ended March 31, 2013, George J. Coates earned additional base compensation of \$43,000, payment of which has been deferred until the Company has sufficient working capital. This amount is included in deferred compensation in the accompanying consolidated balance sheet at March 31, 2013.
- (c) George J. Coates was awarded 6,705,446 unregistered shares of the Company's common stock for anti-dilution protection related to new shares of common stock issued in 2013. The estimated value of these shares, based on the closing trading price of the stock on the dates of issuance was \$203,000.
- (d) For the three months ended March 31, 2013, Bernadette Coates earned additional base compensation of \$6,000, payment of which has been deferred until the Company has sufficient working capital. This amount is included in deferred compensation in the accompanying consolidated balance sheet at March 31, 2013.

Promissory Notes to Related Parties

Issuances of promissory notes to related parties during the three months ended March 31, 2013 and 2012 are discussed in detail in Note 13. The promissory notes to related parties are payable on demand and bear interest at the rate of 17% per annum, compounded monthly.

Issuance of Common Stock and Warrants

Issuances of common stock and common stock warrants to related parties during the three months ended March 31, 2013 are discussed in detail in Note 18. During the three months ended March 31, 2012, the Company sold 190,185 restricted shares of its common stock in consideration for 185,185 tradable shares of its common stock received from the son of Dr. Richard W. Evans, director.

These transactions were private sales of unregistered, restricted securities pursuant to a stock purchase agreement.

Personal Guaranty and Stock Pledge

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.

Other

During the three months ended March 31, 2013 and 2012, Barry C. Kaye, Treasurer and Chief Financial Officer was paid compensation of \$-0- and \$24,000, respectively. For the three months ended March 31, 2013, Mr. Kaye earned compensation of \$29,000, which was not paid and has been deferred until the Company has sufficient working capital to remit payment to him. At March 31, 2013, the total unpaid deferred compensation owed to Mr. Kaye amounted to \$71,000. This amount is included in accounts payable and accrued liabilities in the accompanying consolidated balance sheet at March 31, 2013.

24. LITIGATION AND CONTINGENCIES

Mark D. Goldsmith, a former executive of the Company, filed a lawsuit against the Company in January 2008 in which he asserts that the Company is liable to him for breach of an employment contract that never became effective. In the opinion of management, Mr. Goldsmith's performance was unsatisfactory and, accordingly, he was offered the opportunity to resign. Further, management is of the opinion that the claim of Mr. Goldsmith is baseless because the Company had cause to terminate its relationship with Mr. Goldsmith. The Company intends to vigorously defend this lawsuit and has instituted a counterclaim against Mr. Goldsmith. The Company believes that Mr. Goldsmith misrepresented his background and capabilities to induce it and/or Coates Motorcycle Company, Ltd. to hire him. The Company also contends that certain of Mr. Goldsmith's business decisions were made to further his self-interest rather than its interests. The Company believes that Mr. Goldsmith's claims have no basis in fact and, accordingly, that the outcome of this legal action will not be material to its financial condition or results of operations. Efforts by the court to settle this matter have been unsuccessful. Trial is currently scheduled for May 28, 2013. The Company intends to vigorously defend against Mr. Goldsmith's claims and pursue its counterclaims.

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

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

25. RECENTLY ISSUED ACCOUNTING STANDARD

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

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

This standard became effective for interim periods and fiscal years beginning on or after January 1, 2013. Adoption of this standard did not have a material effect on the Company's consolidated financial statements.

26. SUBSEQUENT EVENTS

Issuance of Convertible Promissory Note

In April 2013, the Company entered into a securities purchase agreement with an investor and issued an 8% convertible promissory note which matures in January 2014 and received cash proceeds of \$40,000, net of financing costs of \$3,000. This note contains the same terms and conditions as the previous convertible promissory notes more fully discussed in Note 14.

Promissory Notes to Related Parties

Subsequent to March 31, 2013, the Company issued additional 17% promissory notes to George J. Coates and received proceeds therefrom of \$8,000.

Subsequent to March 31, 2013, the Company issued additional 17% promissory notes to Bernadette Coates and received proceeds therefrom of \$19,000.

Mr. and Mrs. Coates have made loans to the Company from time to time for working capital purposes but they are not obligated to continue to do so in the future.

Issuance of Common Stock under Equity Line of Credit

Subsequent to March 31, 2013, the Company issued 50,000 registered shares of its common stock under the equity line of credit with Dutchess Opportunity Fund II, LP and received net proceeds of \$1,400.

Deferred Compensation

Subsequent to March 31, 2013, George J. Coates, Barry C. Kaye and Bernadette Coates agreed to additional deferral of their compensation amounting to \$29,000, \$19,000 and \$8,000, respectively, bringing their total deferred compensation to \$72,000, \$90,000 and \$14,000, respectively.

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 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, 2012 filed with the Securities and Exchange Commission.

Background

We have completed development of the Coates spherical rotary valve engine technology. This technology has been successfully applied to natural gas fueled industrial electric power generator engines, automobile engines, residential generators and high performance racing car engines. We have also designed and retrofitted the CSRV system technology into a diesel engine which is suitable for and can be applied to heavy trucks. We have been primarily investing our management time and resources in securing new working capital and developing plans for transitioning to large scale production in order to be properly positioned to take advantage of this technology as it achieves acceptance in the marketplace. This includes consideration of an optimal location, shipping logistics, manufacturing capacity and quality of the labor pool for such large scale manufacturing.

In the fourth quarter of 2011, we identified cracks on the lower engine heads that resulted from a defect in the manufacturing by one of our suppliers. Based on our testing of the Gen Sets to confirm our resolution of this problem, we believe we have determined the cause of this cracked head condition. As soon as the Company raises sufficient working capital, it will procure new cast-steel head castings to resolve the cracked head problems with the engines originally shipped to Almont Energy Inc. ("Almont") and undertake field testing of the generators, after which, it will begin larger scale production. We continue to be engaged in new research and development activities in connection with applying this technology to other commercially feasible internal combustion engine applications and intend to manufacture engines and/or license the CSRV system technology to third party Original Equipment Manufacturers ("OEM's") for multiple other applications and uses.

Plan of Operation

We have completed development of the CSRV system technology-based engine and are prepared to commence the production phase of our operations. When we raise sufficient new working capital, we intend to begin manufacturing and selling natural gas fueled industrial electric power generators powered by CSRV technology based engines (“Gen Sets”) to Almont under (i) a license agreement covering the territory of Canada; and, (ii) certain rights to a license covering the territory of the United States. Almont is a privately held, independent third party entity based in Alberta, Canada.

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

- Assembly – to develop assembly lines within our premises. We intend to initially commence production on a small scale. This will enable us to prove our concept for the CSRV system technology, and we expect this will dovetail with the existing substantial demand in the marketplace. We plan to address this demand by establishing large scale manufacturing operations in the United States. Transitioning to large-scale manufacturing is expected to require a substantial increase in our work force and substantial capital expenditures. To date, we have not been successful in securing the necessary working capital for this purpose.
- Licensing the CSRV system technology to OEM’s – to take advantage of third party manufacturers’ production capacity by signing OEM agreements.

Our ability to establish such manufacturing operations, recruit plant workers, finance initial manufacturing inventories and fund capital expenditures is highly dependent on our ability to successfully raise substantial new working capital in an amount and at a pace which matches our business plans. Possible sources of such new working capital include, sales of our common stock and warrants through private transactions, issuances of promissory notes to related parties, issuances of convertible promissory notes, sales of shares of our common stock through the equity line of credit arrangement with Dutchess Opportunity Fund II, LP, sales of CSRV products, sales of our equity and/or debt securities through private placement offerings, pursuing and entering into additional sublicensing agreements with OEM’s and/or distributors and additional Release Payments from Almont. 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.

Significant Estimates

The preparation of our financial statements in conformity with generally accepted accounting principles in the United States 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, assigning useful lives to the Company’s property, plant and equipment, determining an appropriate amount to reserve for obsolete and slow moving inventory, providing a valuation allowance for deferred tax assets, assigning expected lives to and estimating the rate of forfeitures of stock options granted and selecting a volatility factor for the Company’s stock options in order to estimate the fair value of the Company’s stock options on the date of grant. Actual results could differ from those estimates.

Results of Operations

Three Months Ended March 31, 2013 Compared to the Three Months Ended March 31, 2012 (All amounts rounded to thousands of dollars)

Our principal business activities and efforts for the three months ended March 31, 2013 and 2012 were devoted to (i) undertaking efforts to raise additional working capital in order to fund the start up of large scale manufacturing operations, (ii) preparing applications to, and negotiating with certain states, with the objective of securing a package of business, finance and tax incentives they may be offering to new businesses willing to relocate their operations in order to stimulate their economy and create new jobs within the state; and (iii) developing plans for transitioning to large scale manufacturing. During the three months ended March 31, 2013, we did not engage in any research and development activities. During the three months ended March 31, 2012, we were also engaged, to a limited extent, in research and development activities related to new product applications of the CSRV technology.

Although we incurred substantial net losses for the three months ended March 31, 2013 and 2012 of \$806,000 and \$1,399,000, 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 for operations was significantly less than these net losses. Cash used for operations amounted to (\$189,000) and (\$362,000) in the 2013 and 2012 period, respectively. Included in the net losses for financial reporting purposes for the three months ended March 31, 2013 and 2012 was non-cash stock-based compensation expense of \$292,000 and \$744,000, respectively, unpaid accrued interest expense of \$71,000 and \$156,000, respectively and \$70,000 and (\$29,000) of non-cash expense (income) from the change in the estimated fair value of embedded derivative liabilities related to convertible promissory notes, respectively.

Revenues

There were no sales and no revenues from research and development for the three months ended March 31, 2013 and 2012.

Sublicensing fee revenue for the three months ended March 31, 2013 and 2012, amounted to \$5,000 and \$5,000, respectively. The Company is recognizing the license deposit of \$300,000 on the Canadian License with Almont as revenue over the approximately 16-year remaining life of the last CSRV technology patent in force at that date.

Operating Expenses

Research and Development Expenses

There were no research and development expenses for the three months ended March 31, 2013 because management's time was devoted to the activities discussed above during this period. Research and development expenses for the three months ended March 31, 2012 amounted to \$186,000. Included in research and development expenses for the three months ended March 31, 2012 was \$54,000 of allocated compensation and benefits, \$88,000 of allocated stock-based compensation expense and \$44,000 of parts and materials.

General and Administrative Expenses

General and administrative expenses decreased to \$624,000 for the three months ended March 31, 2013 from \$1,055,000 in the corresponding period in 2012. This net decrease of \$431,000 primarily resulted from the following: A decrease in non-cash stock-based compensation expense of \$363,000, a decrease in legal and professional fees and expenses of \$90,000, a decrease in investor relations expenses of \$38,000 and an increase in miscellaneous income of \$5,000, partially offset by an increase in compensation and benefits of \$38,000 as no compensation and benefits costs were allocated to research and development expenses in the first quarter of 2013, an increase in real estate taxes of \$13,000, an increase in patent maintenance costs of \$10,000, an increase in costs to comply with S.E.C. rules and regulations for publicly reporting companies of \$2,000 and a net increase in other expenses of \$2,000.

Depreciation and Amortization

Depreciation and amortization increased by \$2,000 to \$17,000 for the three months ended March 31, 2013 from \$15,000 for the three months ended March 31, 2012.

Other Income (Expense)

Other income (expense) for the three months ended March 31, 2013 and 2012, consisted of an (increase) decrease in the fair value of embedded derivative liabilities amounting to (\$70,000) and \$29,000, respectively and interest expense of (\$100,000) and (\$177,000), respectively.

Provision for Income Taxes

The change in deferred tax assets for the three months ended March 31, 2013 and 2012 was fully offset by a valuation allowance, resulting in a \$-0- net income tax provision.

Net Loss

We incurred net losses of (\$806,000) and (\$1,399,000) for the three months ended March 31, 2013 and 2012, respectively.

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

Our cash position at March 31, 2013 was \$17,000, an increase of \$4,000 from the cash position of \$13,000 at December 31, 2012. We had negative working capital of (\$4,445,000) at March 31, 2013, which represents a (\$1,448,000) decrease from the (\$5,893,000) of negative working capital at December 31, 2012. Current liabilities of \$4,587,000 at March 31, 2013, decreased by \$1,447,000 from the \$6,034,000 balance at December 31, 2012. Current liabilities were primarily comprised of accounts payable and accrued liabilities of \$1,952,000, a mortgage loan in the amount of \$1,560,000, promissory notes to related parties totaling \$610,000, embedded derivative liabilities related to convertible promissory notes of \$208,000, deferred compensation payable of \$200,000, net carrying value of convertible promissory notes of \$38,000 and unearned revenue of \$19,000.

Operating activities utilized cash of (\$189,000) during the three months ended March 31, 2013, which primarily consisted of a net loss for the period of (\$806,000), decreased by non-cash stock-based compensation expense of \$292,000, non-cash interest expense of \$71,000, a \$70,000 non-cash increase in the estimated fair value of embedded derivative liabilities related to convertible promissory notes, depreciation and amortization of \$17,000 and non-cash financing costs of \$3,000, partially offset by non-cash sublicensing revenues of (\$5,000). In addition, we realized net additional operating cash of \$169,000 from a net increase in accounts payable and accrued liabilities of \$171,000, offset by a reduction in deferred offering costs and other assets of (\$2,000).

There were no investing activities for the three months ended March 31, 2013.

Financing activities generated net cash of \$192,000 for the three months ended March 31, 2013, consisting of proceeds from issuance of common stock and warrants of \$35,000, issuance of common stock under equity line of credit of \$3,000, issuance of convertible notes amounting to \$67,000 and issuance of promissory notes to related parties, net of repayments amounting to \$102,000, offset by a \$15,000 partial repayment of the principal amount of a mortgage loan.

In the opinion of management, we will be required to raise additional working capital to fully achieve our objectives to enter the production phase of our operations. Various potential sources of such additional working capital are anticipated to come from one or more of the following: issuances of convertible promissory notes, issuances of promissory notes to related parties, private sales of common stock and common stock warrants and sales of shares of common stock to Dutchess Opportunity Fund II, LP under the equity line of credit.

Going Concern

We have incurred net recurring losses since inception, amounting to (\$32,033,000), as of March 31, 2013 and had a stockholders' deficiency of (\$2,501,000). We will need to obtain additional working capital in order to continue to cover our ongoing cash expenses. In addition, the mortgage loan on our headquarters and research and development facility matures July 2013. The Company will be required to renegotiate the terms of an extension of the mortgage loan or successfully refinance the property with another mortgage lender, if possible. Failure to do so could adversely affect the Company's financial position and results of operations.

These factors raise substantial doubt about our ability to continue as a going concern. In addition, the current economic environment, which is characterized by tight credit markets, investor uncertainty about how to safely invest funds and low investor confidence, has introduced additional risk and difficulty to our challenge to secure needed additional working capital. Our Independent Registered Public Accountants have stated in their Auditor's Report dated April 15, 2013 with respect to our financial statements as of and for the year ended December 31, 2012 that these circumstances raise substantial doubt about our ability to continue as a going concern.

We have restricted variable costs to only those expenses that are necessary to perform activities related to efforts to raise working capital to enable us to commence production of our CSRV system technology products, research and development and general administrative costs in support of such activities.

During the three months ended March 31, 2013, we raised additional working capital of \$200,000, consisting of proceeds, net of repayments, from issuances of promissory notes to George J. Coates and Bernadette Coates, spouse of George J. Coates amounting to \$65,000 and \$37,000, respectively, net proceeds of a convertible promissory note of \$60,000, proceeds from sales of common stock and warrants to the son of Dr. Richard W. Evans, a director, of \$35,000 and sales of common stock under an equity line of credit of \$3,000.

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

Additional Release Payments are currently due us amounting to \$5,847,000 under the Escrow Agreement with Almont. At this time, Almont is unable to pay the balance due us until it raises sufficient new working capital. As a result, we have needed to rely on other sources for raising new working capital for our operations. Almont, which has been assigned the Canadian License and rights to the US License, is required to remit to us 60% of the proceeds from any new working capital raised, with the exception of proceeds from equipment lease financing transactions. In addition, the annual minimum purchase requirements under both the United States and Canadian licensing agreements of 120 engine generators per year will also become effective upon the commencement of production of the Gen Sets for Almont. At this time, we do not anticipate receiving additional Release Payments until we raise sufficient new working capital to commence production and begin shipments to Almont.

New Accounting Pronouncements

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

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

This standard became effective for interim periods and fiscal years beginning on or after January 1, 2013. Adoption of this standard did not have a material effect on our consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Smaller reporting companies are not required to provide such information.

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 material 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 companies or our 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 2012 Annual Report filed on Form 10-K.

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

The following issuances of securities during the first quarter of 2013 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, we made private sales, pursuant to stock purchase agreements of 999,999 shares of our common stock and 2,000,001 common stock warrants to purchase one share of our common stock at an exercise price of \$0.035 per share in consideration for \$35,000 received from the son of Dr. Richard W. Evans, a director.

In a series of transactions, we issued 6,705,446 shares of our common stock to George J. Coates for anti-dilution protection related to new shares of common stock issued in 2013. The estimated value of these shares, based on the closing trading price of the stock on the dates of issuance was \$203,000.

In March 2013, we issued a \$67,000 principle amount convertible promissory note and received cash proceeds of \$60,000. The lender may convert the promissory note into shares of the Company's common stock at any time beginning 180 days after the date of funding. The conversion rate shall be equal to the lesser of \$0.035 per share or 60% of the lowest trading price of the common stock in the 25 trading days prior to the date of conversion.

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

8% convertible promissory notes issued in June, August and September 2012, with an aggregate principal balance of \$87,500, plus accrued interest of \$4,700 were converted into 5,705,447 shares of common stock.

In January 2013, we issued 20,895,046 shares of our common stock to George J. Coates in satisfaction of a deferred compensation liability consisting of 20,275,046 shares for anti-dilution protection for the year ended December 31, 2012 and a 620,000 share stock award originally granted in 2011. The value of these shares, based on the closing trading price on the dates of the anti-dilution or the date of the stock award was \$1,761,000.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit Number	Description
10.1	Convertible Promissory Note, dated March 20, 2013 between the Company and JMJ Financial and Amendment thereto, dated March 20, 2013
31.1	Section 302 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Section 302 Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS *	XBRL Instance Document
101.SCH	XBRL Taxonomy Schema
*	
101.CAL	XBRL Taxonomy Calculation Linkbase
*	
101.DEF *	XBRL Taxonomy Definition Linkbase
101.LAB	XBRL Taxonomy Label Linkbase
*	
101.PRE *	XBRL Taxonomy Presentation Linkbase
101.DEF *	XBRL Taxonomy Extension Definition Linkbase Document

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

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

SIGNATURES

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

COATES INTERNATIONAL, LTD.

Date: May 15, 2013

/s/ George J. Coates

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

Date: May 15, 2013

/s/ Barry C. Kaye

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

\$355,000 PROMISSORY NOTE

FOR VALUE RECEIVED, **Coates International, LTD**, a Delaware corporation (the "Borrower") with at least 300,000,000 common shares issued and outstanding, promises to pay to JMJ Financial or its Assignees (the "Lender") the Principal Sum along with the Interest Rate and any other fees according to the terms herein. This Note will become effective only upon execution by both parties and delivery of the first payment of Consideration by the Lender (the "Effective Date").

The Principal Sum is \$335,000 (three hundred thirty five thousand) plus accrued and unpaid interest and any other fees. The Consideration is \$300,000 (three hundred thousand) payable by wire (there exists a \$35,000 original issue discount (the "OID")). The Lender shall pay \$60,000 of Consideration upon closing of this Note. The Lender may pay additional Consideration to the Borrower in such amounts and at such dates as Lender may choose in its sole discretion. **THE PRINCIPAL SUM DUE TO LENDER SHALL BE PRORATED BASED ON THE CONSIDERATION ACTUALLY PAID BY LENDER (PLUS AN APPROXIMATE 10% ORIGINAL ISSUE DISCOUNT THAT IS PRORATED BASED ON THE CONSIDERATION ACTUALLY PAID BY THE LENDER AS WELL AS ANY OTHER INTEREST OR FEES) SUCH THAT THE BORROWER IS ONLY REQUIRED TO REPAY THE AMOUNT FUNDED AND THE BORROWER IS NOT REQUIRED TO REPAY ANY UNFUNDED PORTION OF THIS NOTE.** The Maturity Date is one year from the Effective Date of each payment (the "Maturity Date") and is the date upon which the Principal Sum of this Note, as well as any unpaid interest and other fees, shall be due and payable. The Conversion Price is the lesser of \$0.035 or 60% of the lowest trade price in the 25 trading days previous to the conversion (In the case that conversion shares are not deliverable by DWAC an additional 10% discount will apply; and if the shares are ineligible for deposit into the DTC system and only eligible for Xclearing deposit an additional 5% discount shall apply; in the case of both an additional cumulative 15% discount shall apply). Unless otherwise agreed in writing by both parties, at no time will the Lender convert any amount of the Note into common stock that would result in the Lender owning more than 4.99% of the common stock outstanding.

1. **ZERO Percent Interest for the First Three Months.** The Borrower may repay this Note at any time on or before 90 days from the Effective Date, after which the Borrower may not make further payments on this Note prior to the Maturity Date without written approval from Lender. **If the Borrower repays the Note on or before 90 days from the Effective Date the Interest Rate shall be ZERO PERCENT (0%).** If Borrower does not repay the Note on or before 90 days from the Effective Date, a one-time Interest charge of 12% shall be applied to the Principal Sum. Any interest payable is in addition to the OID, and that OID (or prorated OID, if applicable) remains payable regardless of time and manner of payment by Borrower.

2. **Conversion.** The Lender has the right at any time after the Effective Date, at its election, to convert all or part of the outstanding and unpaid Principal Sum and accrued interest (and any other fees) into shares of fully paid and non-assessable shares of common stock of the Borrower as per this conversion formula: Number of shares receivable upon conversion equals the dollar conversion amount divided by the Conversion Price. Conversions may be delivered to Borrower by method of Lender's choice (including but not limited to email, facsimile, mail, overnight courier, or personal delivery), and all conversions shall be cashless and not require further payment from the Lender. If no objection is delivered from Borrower to Lender regarding any variable or calculation of the conversion notice within 24 hours of delivery of the conversion notice, the Borrower shall have been thereafter deemed to have irrevocably confirmed and irrevocably ratified such notice of conversion and waived any objection thereto. The Borrower shall deliver the shares from any conversion to Lender (in any name directed by Lender) within 3 (three) business days of conversion notice delivery.

3. **Conversion Delays.** If Borrower fails to deliver shares in accordance with the timeframe stated in Section 2, Lender, at any time prior to selling all of those shares, may rescind any portion, in whole or in part, of that particular conversion attributable to the unsold shares and have the rescinded conversion amount returned to the Principal Sum with the rescinded conversion shares returned to the Borrower (under Lender's and Borrower's expectations that any returned conversion amounts will tack back to the original date of the Note). In addition, for each conversion, in the event that shares are not delivered by the fourth business day (inclusive of the day of conversion), a penalty of \$2,000 per day will be assessed for each day after the third business day (inclusive of the day of the conversion) until share delivery is made; and such penalty will be added to the Principal Sum of the Note (under Lender's and Borrower's expectations that any penalty amounts will tack back to the original date of the Note).

4. **Reservation of Shares.** At all times during which this Note is convertible, the Borrower will reserve from its authorized and unissued Common Stock to provide for the issuance of Common Stock upon the full conversion of this Note. The Borrower will at all times reserve at least 35,000,000 shares of Common Stock for conversion.

5. **Piggyback Registration Rights.** The Borrower shall include on the next registration statement the Borrower files with SEC (or on the subsequent registration statement if such registration statement is withdrawn) all shares issuable upon conversion of this Note. Failure to do so will result in liquidated damages of 25% of the outstanding principal balance of this Note, but not less than \$25,000, being immediately due and payable to the Lender at its election in the form of cash payment or addition to the balance of his Note.

6. **Terms of Future Financings.** So long as this Note is outstanding, upon any issuance by the Borrower or any of its subsidiaries of any security with any term more favorable to the holder of such security or with a term in favor of the holder of such security that was not similarly provided to the Lender in this Note, then the Borrower shall notify the Lender of such additional or more favorable term and such term, at Lender's option, shall become a part of the transaction documents with the Lender. The types of terms contained in another security that may be more favorable to the holder of such security include, but are not limited to, terms addressing conversion discounts, conversion lookback periods, interest rates, original issue discounts, stock sale price, private placement price per share, and warrant coverage.

7. **Default.** The following are events of default under this Note: (i) the Borrower shall fail to pay any principal under the Note when due and payable (or payable by conversion) thereunder, or (ii) the Borrower shall fail to pay any interest or any other amount under the Note when due and payable (or payable by conversion) thereunder; or (iii) a receiver, trustee or other similar official shall be appointed over the Borrower or a material part of its assets and such appointment shall remain uncontested for twenty (20) days or shall not be dismissed or discharged within sixty (60) days; or (iv) the Borrower shall become insolvent or generally fails to pay, or admits in writing its inability to pay, its debts as they become due, subject to applicable grace periods, if any; or (v) the borrower shall make a general assignment for the benefit of creditors; or (vi) the Borrower shall file a petition for relief under any bankruptcy, insolvency or similar law (domestic or foreign); or (vii) an involuntary proceeding shall be commenced or filed against the Borrower; or (viii) the Borrower shall lose its status as "DTC Eligible" or the borrower's shareholders shall lose the ability to deposit (either electronically or by physical certificates, or otherwise) shares into the DTC System; or (ix) the Borrower shall become delinquent in its filing requirements as a fully-reporting issuer registered with the SEC.

8. **Remedies.** In the event of any default, the outstanding principal amount of this Note, plus accrued but unpaid interest, liquidated damages, fees and other amounts owing in respect thereof through the date of acceleration, shall become, at the Lender's election, immediately due and payable in cash at the Mandatory Default Amount. The Mandatory Default Amount means the greater of (i) the outstanding principal amount of this Note, plus all accrued and unpaid interest, liquidated damages, fees and other amounts hereon, divided by the Conversion Price on the date the Mandatory Default Amount is either demanded or paid in full, whichever has a lower Conversion Price, multiplied by the VWAP on the date the Mandatory Default Amount is either demanded or paid in full, whichever has a higher VWAP, or (ii) 150% of the outstanding principal amount of this Note, plus 100% of accrued and unpaid interest, liquidated damages, fees and other amounts hereon. Commencing five (5) days after the occurrence of any event of default that results in the eventual acceleration of this Note, the interest rate on this Note shall accrue at an interest rate equal to the lesser of 18% per annum or the maximum rate permitted under applicable law. In connection with such acceleration described herein, the Lender need not provide, and the Borrower hereby waives, any presentment, demand, protest or other notice of any kind, and the Lender may immediately and without expiration of any grace period enforce any and all of its rights and remedies hereunder and all other remedies available to it under applicable law. Such acceleration may be rescinded and annulled by Lender at any time prior to payment hereunder and the Lender shall have all rights as a holder of the note until such time, if any, as the Lender receives full payment pursuant to this Section 8. No such rescission or annulment shall affect any subsequent event of default or impair any right consequent thereon. Nothing herein shall limit Lender's right to pursue any other remedies available to it at law or in equity including, without limitation, a decree of specific performance and/or injunctive relief with respect to the Borrower's failure to timely deliver certificates representing shares of Common Stock upon conversion of the Note as required pursuant to the terms hereof.

9. **No Shorting.** Lender agrees that so long as this Note from Borrower to Lender remains outstanding, Lender will not enter into or effect "short sales" of the Common Stock or hedging transaction which establishes a net short position with respect to the Common Stock of Borrower. Borrower acknowledges and agrees that upon delivery of a conversion notice by Lender, Lender 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.

10. **Assignability.** The Borrower may not assign this Note. This Note will be binding upon the Borrower and its successors and will inure to the benefit of the Lender and its successors and assigns and may be assigned by the Lender to anyone of its choosing without Borrower's approval.

11. **Governing Law.** This Note will be governed by, and construed and enforced in accordance with, the laws of the State of Florida, without regard to the conflict of laws principles thereof. 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 Florida or in the federal courts located in Miami-Dade County, in the State of Florida. Both parties and the individuals signing this Agreement agree to submit to the jurisdiction of such courts

12. **Delivery of Process by Lender to Borrower.** In the event of any action or proceeding by Lender against Borrower, and only by Lender against Borrower, service of copies of summons and/or complaint and/or any other process which may be served in any such action or proceeding may be made by Lender via U.S. Mail, overnight delivery service such as FedEx or UPS, email, fax, or process server, or by mailing or otherwise delivering a copy of such process to the Borrower at its last known attorney as set forth in its most recent SEC filing.

13. **Attorney Fees.** In the event any attorney is employed by either party to this Note with regard to any legal or equitable action, arbitration or other proceeding brought by such party for the enforcement of this Note or because of an alleged dispute, breach, default or misrepresentation in connection with any of the provisions of this Note, the prevailing party in such proceeding will be entitled to recover from the other party reasonable attorneys' fees and other costs and expenses incurred, in addition to any other relief to which the prevailing party may be entitled.

14. **Opinion of Counsel.** In the event that an opinion of counsel is needed for any matter related to this Note, Lender has the right to have any such opinion provided by its counsel. Lender also has the right to have any such opinion provided by Borrower's counsel.

15. **Notices.** Any notice required or permitted hereunder (including Conversion Notices) must be in writing and either personally served, sent by facsimile or email transmission, or sent by overnight courier. Notices will be deemed effectively delivered at the time of transmission if by facsimile or email, and if by overnight courier the business day after such notice is deposited with the courier service for delivery.

Borrower:

/s/ George J. Coates

George J. Coates
Coates International, Ltd.
Chairman and Chief Financial Officer

Lender:

/s/ Justin Keener

JMJ Financial
Its Principal

Date: March 20, 2013

Date: March 20, 2013

**AMENDMENT
TO THE \$335,000 PROMISSORY NOTE DATED MARCH 20, 2013**

The parties agree that the \$335,000 Promissory Note by and between Coates International, LTD. and JMJ Financial is hereby amended as follows:

No Conversions for 180 days. The first sentence of Section 2 of the Note, which begins with "The Lender has the right, at any time after the Effective Date, at its election,..", shall be amended by inserting the words "from 180 days" into the sentence so that the sentence begins as follows: "The Lender has the right, at any time from 180 days after the Effective Date, at its election.. .."

ALL OTHER TERMS AND CONDITIONS OF THE \$335,000 PROMISSORY NOTE REMAIN IN FULL FORCE AND EFFECT.

Please indicate acceptance and approval of this amendment dated March 20, 2013 by signing below:

Borrower:

/s/ George J. Coates

George J. Coates
Coates International, Ltd.
Chairman and Chief Financial Officer

Lender:

/s/ Justin Keener

JMJ Financial
Its Principal

Date: March 20, 2013

Date: March 20, 2013

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

I, George J. Coates, 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: May 15, 2013

/s/ George J. Coates

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

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

I, Barry C. Kaye, certify that:

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

Date: May 15, 2013

/s/ Barry C. Kaye

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

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

In connection with the Quarterly Report of Coates International, Ltd. (the “Company”) on Form 10-Q for the period ended March 31, 2013 (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: May 15, 2013

/s/ George J. Coates

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

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

In connection with the Quarterly Report of Coates International, Ltd. (the "Company") on Form 10-Q for the period ended March 31, 2013 (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: May 15, 2013

/s/ Barry C. Kaye

Barry C. Kaye

Treasurer and Chief Financial Officer
(Principal Accounting Officer)