

CoroWare, Inc,  
Form 10-Q  
November 21, 2011

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

---

FORM 10-Q

---

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

For the quarterly period ended September 30, 2011

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

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

COMMISSION FILE NUMBER: 000-33231

COROWARE, INC.

(EXACT NAME OF THE COMPANY AS SPECIFIED IN ITS CHARTER)

Delaware  
(State or Other  
Jurisdiction  
of Incorporation) 95-4868120  
(I.R.S. Employer  
Identification No.)

1410 Market Street, Suite 200  
Kirkland, WA 98033

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(800) 641-2676

(ISSUER REGISTRANT TELEPHONE NUMBER)

Indicate by check mark whether the Company (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 Company 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 Company (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 Company was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

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

Edgar Filing: CoroWare, Inc, - Form 10-Q

Large accelerated filer  Accelerated filer   
Non-accelerated filer  
(Do not check if a smaller  Smaller reporting company   
reporting company

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

As of November 14, 2011 there were 796,117,874 shares of the issuer's \$.001 par value common stock outstanding.

-1-

---

COROWARE, INC.  
September 30, 2011 QUARTERLY REPORT ON FORM 10-Q

TABLE OF CONTENTS

PAGE

PART I – FINANCIAL INFORMATION

- Item 1. Consolidated Financial Statements
  - Consolidated Balance Sheets at September 30, 2011 (Unaudited) and December 31, 2010
  - Unaudited Consolidated Statements of Operations for the three and nine months ended September 30, 2011 and 2010
  - Unaudited Consolidated Statements of Cash Flows for the nine months ended September 30, 2011 and 2010
  - Notes to Unaudited Consolidated Financial Statements
- Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations
- Item 3. Quantitative and Qualitative Disclosures About Market Risk
- Item 4. Controls and Procedures

PART II – OTHER INFORMATION

- Item 1. Legal Proceedings
- Item 1A. Risk Factors
- Item 2. Unregistered Sales of Equity Securities and Use of Funds
- Item 3. Defaults Upon Senior Securities
- Item 4. Removed and Reserved
- Item 5. Other Information
- Item 6. Exhibits

SIGNATURES

COROWARE, INC.  
CONSOLIDATED BALANCE SHEETS

ASSETS

	September 30, 2011 (Unaudited)	December 31, 2010
Current assets:		
Cash	\$16,614	\$-
Accounts receivable, net	152,865	188,988
Inventory	3,967	4,818
Other current assets	13,434	10,673
Total current assets	186,880	204,479
Property and equipment, net	26,017	31,391
Intangible assets, net	-	11,081
Other assets, net	8,233	4,731
<b>TOTAL ASSETS</b>	<b>\$221,130</b>	<b>\$251,682</b>

LIABILITIES AND STOCKHOLDERS' DEFICIT

Current liabilities:		
Lines of credit	\$128,780	\$124,991
Obligations collateralized by receivables	95,796	102,389
Accounts payable and accrued expenses	4,334,579	3,811,415
Accrued expenses, related parties	110,916	150,536
Notes payable	202,232	263,133
Notes payable, related parties	220,269	292,812
Derivative liability	4,905,910	1,825,216
Current maturities of convertible debt, net of discount	2,127,447	2,292,410
Redeemable preferred stock, Series B, \$.001 par value, 10,000,000 shares authorized, 159,666 shares issued and outstanding as of September 30, 2011 and December 31, 2010	425,775	260,958
Small Business Administration Loan	980,450	982,450
Total current liabilities	13,532,153	10,106,310
Long term liabilities:		
Convertible debt, net of discount and current portion	127,373	-
Total liabilities	13,659,526	10,106,310
Commitments		
Stockholders' deficit:		
Common stock, \$.001 par value, 900,000,000 shares authorized, 796,117,874 and 88,590,637 shares issued and 796,117,040 and outstanding at September 30, 2011 and December 31, 2010, respectively	88,589,803	
	796,119	88,591
Additional paid-in capital	15,437,740	15,530,450
Accumulated deficit	(29,636,555)	(25,437,969)
Treasury stock	(35,700 )	(35,700 )

Total stockholders' deficit	(13,438,396)	(9,854,628 )
<b>TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT</b>	<b>\$221,130</b>	<b>\$251,682</b>

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

-3-

---

COROWARE, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
For the Three and Nine Months ended September 30, 2011 and 2010  
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Revenues	\$389,089	\$376,648	\$1,277,358	\$1,555,270
Cost of revenues	289,945	243,621	849,347	1,176,497
Gross profit	99,144	133,027	428,011	378,773
Operating expenses:				
General and administrative	182,588	241,093	658,083	730,606
Sales and marketing	68,824	176,636	251,322	271,759
Research and development	20,372	51,097	106,562	86,904
Depreciation and amortization	3,000	10,550	20,081	31,350
Total operating expenses	274,784	479,376	1,036,048	1,120,619
Loss from operations	(175,640 )	(346,349 )	(608,037 )	(741,846 )
Other income (expense):				
Derivative income (expense)	(2,561,925 )	(923,670 )	(3,021,883 )	76,772
Interest expense, net	(198,518 )	(142,061 )	(567,600 )	(559,615 )
Other income	-	-	-	30,156
Gain (Loss) on settlement of liabilities and mortgage note	-	-	(76,582 )	-
Gain on convertible debt redemptions	114	4,015	75,517	36,575
Total other income (expense)	(2,760,329 )	(1,061,716 )	(3,590,548 )	(416,112 )
Net income (loss)	\$(2,935,969 )	\$(1,408,065 )	\$(4,198,586 )	\$(1,157,958 )
Net income (loss) loss per share:				
Basic	\$(0.01 )	\$(0.06 )	\$(0.01 )	\$0.08
Diluted	\$(0.01 )	\$(0.06 )	\$(0.01 )	\$0.08
Weighted average shares outstanding:				
Basic	780,662,179	24,634,725	498,096,006	15,356,860
Diluted	780,662,179	24,634,725	498,096,006	15,356,860

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

COROWARE, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
For the Nine Months Ended September 30, 2011 and 2010  
(Unaudited)

	2011	2010
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income (loss)	\$(4,198,586)	\$(1,157,958)
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	20,081	31,350
Stock option expense	-	19,313
Amortization of debt discount	205,123	59,444
Amortization of deferred financing costs	5,499	6,250
Derivative (income) expense	3,021,883	(76,772 )
Gain on convertible debt redemptions	(75,516 )	(47,724 )
Common stock issued for services	3,300	132,037
(Gain) loss on settlement of liabilities with stock	75,134	-
Gain on partial settlement of mortgage note		-
Changes in operating assets and liabilities:		
Accounts receivable, net	36,123	22,157
Other current assets, net	(2,909 )	20,630
Accounts payable and accrued expenses	860,101	305,052
Accrued expenses, related parties	(8,155 )	683,328
<b>NET CASH FLOWS FROM OPERATING ACTIVITIES</b>	<b>(57,922 )</b>	<b>(2,893 )</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Additions to property and equipment	(3,626 )	-
<b>NET CASH FLOWS FROM INVESTING ACTIVITIES</b>	<b>(3,626 )</b>	<b>-</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Obligations collateralized by receivables	(6,593 )	43,066
Proceeds from lines of credit, net	3,789	1,387
Payments on notes payable	(8,692 )	(70,000 )
Payments on notes payable, related parties	(3,342 )	(35,053 )
Payments on long-term debt	(2,000 )	-
Proceeds from convertible debentures, net of financing costs	80,000	-
Proceeds from notes payable	15,000	40,000
Proceeds from notes payable, related party	-	20,000
<b>NET CASH FLOWS FROM FINANCING ACTIVITIES</b>	<b>78,162</b>	<b>(600 )</b>
<b>NET INCREASE IN CASH</b>	<b>16,614</b>	<b>(3,493 )</b>
Cash, beginning of period	-	3,493
Cash, end of period	\$16,614	\$-

Continued.





COROWARE, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)  
For the Nine Months Ended September 30, 2011 and 2010  
(Unaudited)

	2011	2010
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>		
Interest paid	\$-	\$1,000
Income taxes paid	\$-	\$-
<b>NON-CASH INVESTING AND FINANCING TRANSACTIONS</b>		
Common stock issued for redemption of convertible debentures	\$330,669	\$18,569
Common stock issued in satisfaction of accrued liabilities	\$280,849	\$55,961
Common stock issued for joint venture contribution	\$-	\$20,000
Common stock issued in satisfaction of note payable	\$-	\$3,574

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

COROWARE, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

NOTE 1 – BASIS OF PRESENTATION

The accompanying unaudited interim consolidated financial statements of CoroWare, Inc. (“CoroWare” or “the Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules of the Securities and Exchange Commission (“SEC”), and should be read in conjunction with the audited financial statements and notes thereto contained in the Company’s annual report filed with the SEC on Form 10-K for the year ended December 31, 2010. The consolidated financial statements include the accounts of the Company and its wholly-owned operating subsidiary, CoroWare Technologies, Inc. Also included in the consolidated statements are the Company’s inactive wholly-owned subsidiaries, Innova Robotics, Inc., Robotic Workspace Technologies, Inc., and Robotics Software Service, Inc. (herein referred to as the “Subsidiaries”). In the opinion of management, all adjustments consisting of normal recurring adjustments necessary for a fair presentation of financial position and the results of operations for the interim periods presented have been reflected herein. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year. Notes to the financial statements which would substantially duplicate the disclosure contained in the audited financial statements for the most recent fiscal year ended December 31, 2010 as reported in Form 10-K have been omitted.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Subsequent Events

The Company evaluated events occurring between the end of the current period and the date these financial statements were issued for potential subsequent event disclosures.

Recent Accounting Pronouncements

Management does not expect the impact of any other recently issued accounting pronouncements to have a material impact on its financial condition or results of operations.

NOTE 3 – FINANCIAL CONDITION AND GOING CONCERN

The Company has a loss from operations for the nine months ended September 30, 2011 of \$608,037. Because of this loss, the current working capital deficit, and the projection of additional losses for the remainder of 2011, the Company will require additional working capital to develop its business operations.

The Company intends to raise additional working capital through the use of public offerings and/or related party financings.

There are no assurances that the Company will be able to either (1) achieve a level of revenues adequate to generate sufficient cash flow from operations; or (2) obtain additional financing through either private placements, public offerings, bank financing and/or related party financing necessary to support the Company's working capital requirements. To the extent that funds generated from operations, any private placements, public offerings, bank financing and/or related party financings are insufficient, the Company will have to raise additional working capital. No assurance can be given that additional financing will be available or, if available, will be on terms acceptable to the Company.

These conditions raise substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

COROWARE, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

## NOTE 4 – ACCOUNTS RECEIVABLE FACTORING

In March 2010, the Company entered into an accounts receivable factoring arrangement with Capefirst Funding, LLC. (“Capefirst”). The agreement calls for Capefirst to advance up to 80% of the net face amount of each assigned account or up to 50% of eligible assigned purchase orders. The agreement calls for a maximum facility amount of \$200,000 with a purchase fee of 2% of the net face amount of each assigned account and a collection fee of 0.1% compounded daily. In the event of a dispute or in the event of fraud, misrepresentation, willful misconduct or negligence on the part of the Company, Capefirst may require the Company to immediately repurchase the assigned accounts at a purchase price that includes the amount of the assigned account plus the discount fee, interest and collection fee and may include a processing fee of 10%. At September 30, 2011, approximately \$95,800 of our receivables had been factored.

## NOTE 5 - CONVERTIBLE DEBT

The following table illustrates the carrying value of convertible debt

	September 30, 2011	December 31, 2010
\$2,825,000 Yorkville financing (a)	\$478,258	\$1,380,141
\$ 600,000 Yorkville financing	600,000	600,000
\$ 300,000 Yorkville financing	300,000	300,000
\$ 75,000 Collins financing	24,460	12,269
\$ 27,500 Asher financing (b)	15,386	-
\$ 10,750 Barclay financing (c)	10,750	-
\$ 9,750 Mackie financing (d)	9,750	-
\$ 170,562 Ratzker financing (e)	68,676	-
\$ 67,042 Harvey financing (f)	51,751	-
\$ 89,383 Cariou financing (g)	69,463	-
\$ 10,000 Tangiers financing (i)	6,316	-
\$ 15,000 Tangiers financing (j)	7,809	-
\$ 65,000 Panache financing (k)	13,434	-
\$ 15,000 Panache financing (l)	2,752	-
\$ 567,200 Westmount financing (m)	537,318	-
\$ 170,561 Redwood financing (n)	58,697	-
	2,254,820	2,292,410
Less: Current portion of convertible debt	(2,127,447)	(2,292,410)
Long term portion of convertible debt	\$ 127,373	\$-

(a)\$2,825,000 Yorkville financing:

On December 31, 2010, Yorkville assigned 46.3% of Tranche 1 of its \$2,825,000 debenture (aggregating \$341,123 principal and \$227,140 interest) to an unrelated third party (“Ratzker”). See discussion below in Note 5(e). On April 12, 2011, Yorkville assigned 100% of Tranche 2 of its \$2,825,000 debenture (aggregating \$567,200 in principal and \$317,510 in interest) to an unrelated third party (“Westmount”). See discussion below in Note 5(m).

Yorkville maintains face value of debt aggregating \$478,258 which represents the remaining 53.7% of Tranche 1 and 100% of Tranche 3 of \$395,628 and \$82,630, respectively. During the three month period ending September 30, 2011, there were no conversions from Tranche 1 or Tranche 3.

-8-

---

COROWARE, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

(b) \$27,500 Asher financing:

On February 1, 2011, the Company consummated an unsecured Securities Purchase Agreement with an unrelated third party for the sale by the Company of its 8% secured convertible debentures in the aggregate principal amount of \$27,500, net of deferred financing costs of \$2,500.

The debenture matures on November 3, 2011, nine months from the date of issuance. The holder of the debenture may, at any time, convert amounts outstanding under the debenture into shares of common stock of the Company at a conversion rate equal to 51% of the market price, which is defined as the lowest 3 trading prices for the Company's common stock during the 10 trading days prior to conversion.

In the Company's evaluation of this instrument in accordance with ASC 815 Derivatives and Hedging, based on the variable conversion price and lack of authorized shares, it was determined that the conversion feature was not afforded the exemption as a conventional convertible instrument and did not otherwise meet the conditions for equity classification. As such, the conversion and other features were compounded into one instrument, bifurcated from the debt instrument and carried as a derivative liability, at fair value. The Company estimated the fair value of the bifurcated derivative instruments using the Monte Carlo valuation model because this methodology provides for all of the necessary assumptions necessary for fair value determination; including assumptions for credit risk, interest risk and conversion/redemption behavior. Significant assumptions underlying this methodology were: effective term (using the remaining term of the host instrument); effective volatility (145.01% - 130.17%); and effective risk adjusted yield (12.5%). As a result of these estimates, the valuation model resulted in a compound derivative balance of \$36,729 at inception. Derivative expense of \$9,229 was recognized at inception.

During the three month period ending September 30, 2011, Asher converted \$2,000 of the convertible debenture into 33,333,333 shares of the Company's common stock. The Company recognized a loss on redemption of \$114.

(c) \$10,750 Barclay financing:

On January 28, 2011, the Company consummated an unsecured convertible promissory note with an unrelated third party for \$10,750, net of deferred financing costs of \$2,500.

The debenture matured on July 28, 2011 and is currently in default. The holder of the debenture may, at any time, convert amounts outstanding under the debenture into shares of common stock of the Company at a conversion rate equal to 50% of the fair market value, but not to exceed \$0.05/share or be less than \$0.0001/share. Fair market value is defined as the lower of i) the closing bid price for the date immediately preceding the date of conversion (excluding trades that are not arms-length) or ii) the average of last 5 trading days volume weighted average price. The Company's obligations under the convertible promissory note are secured by substantially all of the assets of the Company and those of its wholly owned subsidiary, CoroWare Technologies, Inc.

In the Company's evaluation of this instrument in accordance with ASC 815 Derivatives and Hedging, based on the variable conversion price and lack of authorized shares, it was determined that the conversion feature was not afforded the exemption as a conventional convertible instrument and did not otherwise meet the conditions for equity classification. As such, the conversion and other features were compounded into one instrument, bifurcated from the debt instrument and carried as a derivative liability, at fair value. The Company estimated the fair value of the bifurcated derivative instruments using the Monte Carlo valuation model because this methodology provides for all of the necessary assumptions necessary for fair value determination; including assumptions for credit risk, interest risk

and conversion/redemption behavior. Significant assumptions underlying this methodology were: effective term (using the remaining term of the host instrument); effective volatility (155.39% - 117.57%); and effective risk adjusted yield (12.5%). As a result of these estimates, the valuation model resulted in a compound derivative balance of \$12,369 at inception. Derivative expense of \$1,619 was recognized at inception.

-9-

---

COROWARE, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

As of September 30, 2011, there have been no conversions on this convertible debenture.

(d) \$9,750 Mackie financing:

On February 3, 2011, the Company consummated an unsecured convertible promissory note with an unrelated third party for \$9,750.

The debenture matured February 18, 2011, two weeks from the date of issuance. The note is currently in default. The holder of the debenture may, at any time, convert amounts outstanding under the debenture into shares of common stock of the Company at a conversion rate equal to 85% of the 5 day average closing price using the 5 trading days prior to the conversion date.

In the Company's evaluation of this instrument in accordance with ASC 815 Derivatives and Hedging, based on the variable conversion price and lack of authorized shares, it was determined that the conversion feature was not afforded the exemption as a conventional convertible instrument and did not otherwise meet the conditions for equity classification. As such, the conversion and other features were compounded into one instrument, bifurcated from the debt instrument and carried as a derivative liability, at fair value. The Company estimated the fair value of the bifurcated derivative instruments using the Monte Carlo valuation model because this methodology provides for all of the necessary assumptions necessary for fair value determination; including assumptions for credit risk, interest risk and conversion/redemption behavior. Significant assumptions underlying this methodology were: effective term (using the remaining term of the host instrument); effective volatility (155.39% - 117.57%); and effective risk adjusted yield (12.5%). As a result of these estimates, the valuation model resulted in a compound derivative balance of \$3,491 at inception. The remaining balance of \$6,259 was allocated to the carrying value of the debenture.

As of September 30, 2011, there have been no conversions on this convertible debenture.

(e) \$ 170,562 Ratzker financing:

Yorkville Advisors transferred a 46.3% portion of Tranche 1 of the \$2,825,000 debenture to a third party ("Ratzker") effective December 31, 2010. The assignment aggregated \$568,263, representing \$341,123 of unpaid principal and \$227,140 of accrued interest. At that time, there was no accounting impact for CoroWare as it was merely an assignment between debt holders. On March 18, 2011, Ratzker modified the terms of the debenture such that the interest rate was lowered from 14% to 5% and the maturity date was extended until March 18, 2013. Simultaneously, the conversion rate on the debenture was modified from 85% of the 30 day Volume Weighted Average Price ("VWAP") to 65% of the 30 day VWAP.

The modification was analyzed in accordance with current accounting standards and was determined not to be a troubled debt restricting or an extinguishment of debt. As such, it was accounted for as a modification and no gain or loss was recognized on the transaction. A debt discount of \$236,779 was recognized for the difference in the fair value of the embedded conversion feature before and after the modification date. A new effective rate was calculated for the new debenture and the related debt discount is being amortized using the effective interest rate over the new 2 year term of the underlying loan. Amortization for the three month period ended September 30, 2011 was \$10,862.

On March 21, 2011, this third party transferred 50% of his ownership interest in this debenture to another unrelated party ("Redwood"). The terms of the debenture did not change with that transfer. As such, this transfer was also considered an assignment between debt holders and did not have an accounting impact on the Company. See



discussion below in Note 5(n) for Redwood financing. No conversions were made on the Ratzker debenture during the quarter ending September 30, 2011.

With the extension of the maturity date, this debenture is no longer in default and has been reclassified to long-term liabilities on the accompanying balance sheet.

-10-

---

COROWARE, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

As of September 30, 2011, there have been no conversions on this convertible debenture.

(f) \$67,042 Harvey financing:

On April 2, 2011, the Company entered into an unsecured convertible promissory note with a vendor. The vendor converted \$67,042 of outstanding payables into this convertible note. The note calls for interest at 10% through the maturity date of May 2, 2011 and default interest at 15% thereafter.

The holder of the debenture may, at any time, convert amounts outstanding under the debenture into shares of common stock of the Company at a conversion rate equal to the average closing bid price for the 5 trading days prior to, but not including, the conversion date. The number of shares of common stock to be issued upon each conversion shall be determined by dividing that portion of the principal to be converted by the conversion price then multiplying by 115%.

In the Company's evaluation of this instrument in accordance with ASC 815 Derivatives and Hedging, based on the variable conversion price and lack of authorized shares, it was determined that the conversion feature was not afforded the exemption as a conventional convertible instrument and did not otherwise meet the conditions for equity classification. As such, the conversion and other features were compounded into one instrument, bifurcated from the debt instrument and carried as a derivative liability, at fair value. The Company estimated the fair value of the bifurcated derivative instruments using the Monte Carlo valuation model because this methodology provides for all of the necessary assumptions necessary for fair value determination; including assumptions for credit risk, interest risk and conversion/redemption behavior. Significant assumptions underlying this methodology were: effective term (using the remaining term of the host instrument); effective volatility (132.38%); and effective risk adjusted yield (12.5%). As a result of these estimates, the valuation model resulted in a compound derivative balance of \$30,011 at inception.

As of September 30, 2011, there have been no conversions on this convertible debenture.

(g) \$89,383 Cariou financing:

On April 4, 2011, the Company entered into unsecured convertible promissory note with an employee. The employee converted \$56,700 of outstanding principal on related party notes payable and \$32,683 of accrued interest into this convertible note. The note calls for interest at 10% through the maturity date of May 4, 2011 and default interest at 15% thereafter.

The holder of the debenture may, at any time, convert amounts outstanding under the debenture into shares of common stock of the Company at a conversion rate equal to the average closing bid price for the 5 trading days prior to, but not including, the conversion date. The number of shares of common stock to be issued upon each conversion shall be determined by dividing that portion of the principal to be converted by the conversion price then multiplying by 115%.

In the Company's evaluation of this instrument in accordance with ASC 815 Derivatives and Hedging, based on the variable conversion price and lack of authorized shares, it was determined that the conversion feature was not afforded the exemption as a conventional convertible instrument and did not otherwise meet the conditions for equity classification. As such, the conversion and other features were compounded into one instrument, bifurcated from the debt instrument and carried as a derivative liability, at fair value. The Company estimated the fair value of the

bifurcated derivative instruments using the Monte Carlo valuation model because this methodology provides for all of the necessary assumptions necessary for fair value determination; including assumptions for credit risk, interest risk and conversion/redemption behavior. Significant assumptions underlying this methodology were: effective term (using the remaining term of the host instrument); effective volatility (132.38%); and effective risk adjusted yield (12.5%). As a result of these estimates, the valuation model resulted in a compound derivative balance of \$44,720 at inception.

As of September 30, 2011, there have been no conversions on this convertible debenture.

COROWARE, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

(h) \$25,000 Tangiers financing:

In May and June 2011, an unrelated third party (“Tangiers”) purchased a \$25,000 note payable from one of CoroWare’s note holders. The transaction was completed in 2 Tranches of \$10,000 and \$15,000. The terms of the note were changed such that the conversion rate was changed from a fixed \$1 per share to a variable rate of 65% of the lowest trading price during the 7 days prior to conversion. The interest rate was changed from 8% to 10% and the maturity date was extended from June 2003 to March 19, 2012, thus taking the note out of default.

The modification was analyzed in accordance with current accounting standards and was determined not to be a troubled debt restricting but rather an extinguishment of debt as there was a substantial difference in terms on the new debt. As the old debt was being carried at face value, there was no gain or loss recognized on the extinguishment.

In the Company’s evaluation of this instrument in accordance with ASC 815 Derivatives and Hedging, based on the variable conversion price and lack of authorized shares, it was determined that the conversion feature was not afforded the exemption as a conventional convertible instrument and did not otherwise meet the conditions for equity classification. As such, the conversion and other features were compounded into one instrument, bifurcated from the debt instrument and carried as a derivative liability, at fair value. The Company estimated the fair value of the bifurcated derivative instruments using the Monte Carlo valuation model because this methodology provides for all of the necessary assumptions necessary for fair value determination; including assumptions for credit risk, interest risk and conversion/redemption behavior. Significant assumptions underlying this methodology were: effective term (using the remaining term of the host instrument); effective volatility (132.38%); and effective risk adjusted yield (12.5%). As a result of these estimates, the valuation model resulted in a compound derivative balance of \$11,662 and \$10,800, respectively, at inception for the \$10,000 tranche and the \$15,000 tranche.

During the three months ended June 30, 2011, the entire \$25,000 was converted into 96,153,846 shares of CoroWare common stock. CoroWare recognized a loss of \$16,923 and \$13,846, respectively, on the conversion of the \$10,000 tranche and the \$15,000 tranche.

(i) \$10,000 Tangiers financing:

On May 16, 2011, the Company entered into a \$10,000 Convertible Note Agreement with an unrelated third party (“Tangiers”). The note calls for interest at 10% through the maturity date of May 16, 2012 and default interest at 20% thereafter. Loan fees of \$1,300 were withheld at closing. These have been classified as deferred finance costs and are being amortized over the term of the loan on a straight line basis.

The holder of the debenture may, at any time, convert amounts outstanding under the debenture into shares of common stock of the Company at a conversion rate equal to 65% of the lowest trading price in the 7 days prior to the conversion date. Upon default, the conversion price changes to 40% of the lowest trading price in the 7 days prior to the conversion date.

In the Company’s evaluation of this instrument in accordance with ASC 815 Derivatives and Hedging, based on the variable conversion price and lack of authorized shares, it was determined that the conversion feature was not afforded the exemption as a conventional convertible instrument and did not otherwise meet the conditions for equity classification. As such, the conversion and other features were compounded into one instrument, bifurcated from the debt instrument and carried as a derivative liability, at fair value. The Company estimated the fair value of the bifurcated derivative instruments using the Monte Carlo valuation model because this methodology provides for all of

the necessary assumptions necessary for fair value determination; including assumptions for credit risk, interest risk and conversion/redemption behavior. Significant assumptions underlying this methodology were: effective term (using the remaining term of the host instrument); effective volatility (132.38%); and effective risk adjusted yield (12.5%). As a result of these estimates, the valuation model resulted in a compound derivative balance of \$5,877 at inception.

COROWARE, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

As of September 30, 2011, there have been no conversions on this convertible debenture.

(j) \$15,000 Tangiers financing:

On June 10, 2011, the Company entered into a \$15,000 Convertible Note Agreement with an unrelated third party (“Tangiers”). The note calls for interest at 10% through the maturity date of May 16, 2012 and default interest at 20% thereafter. Loan fees of \$1,300 were withheld at closing. These have been classified as deferred finance costs and are being amortized over the term of the loan on a straight line basis.

The holder of the debenture may, at any time, convert amounts outstanding under the debenture into shares of common stock of the Company at a conversion rate equal to 65% of the lowest trading price in the 7 days prior to the conversion date. Upon default, the conversion price changes to 40% of the lowest trading price in the 7 days prior to the conversion date.

In the Company’s evaluation of this instrument in accordance with ASC 815 Derivatives and Hedging, based on the variable conversion price and lack of authorized shares, it was determined that the conversion feature was not afforded the exemption as a conventional convertible instrument and did not otherwise meet the conditions for equity classification. As such, the conversion and other features were compounded into one instrument, bifurcated from the debt instrument and carried as a derivative liability, at fair value. The Company estimated the fair value of the bifurcated derivative instruments using the Monte Carlo valuation model because this methodology provides for all of the necessary assumptions necessary for fair value determination; including assumptions for credit risk, interest risk and conversion/redemption behavior. Significant assumptions underlying this methodology were: effective term (using the remaining term of the host instrument); effective volatility (132.38%); and effective risk adjusted yield (12.5%). As a result of these estimates, the valuation model resulted in a compound derivative balance of \$10,800 at inception.

As of September 30, 2011, there have been no conversions on this convertible debenture.

(k) \$65,000 Panache financing:

On June 2, 2011, an unrelated third party (“Panache”) purchased an aggregate \$65,000 (representing \$30,000 of outstanding principal and \$35,000 accrued interest) from one of CoroWare’s note holders. The terms of the note were changed such that the conversion rate was changed from a fixed \$1 per share to a variable rate of an agreed to discount to market not to fall below a 50% discount to the average of the 3 lowest trading prices during the 20 days prior to conversion. The interest rate was changed from 8% to 15% and the maturity date was extended from June 2003 to June 1, 2012, thus taking the note out of default.

The modification was analyzed in accordance with current accounting standards and was determined not to be a troubled debt restructuring but rather an extinguishment of debt as there was a substantial difference in terms on the new debt. As the old debt was being carried at face value, there was no gain or loss recognized on the extinguishment.

In the Company’s evaluation of this instrument in accordance with ASC 815 Derivatives and Hedging, based on the variable conversion price and lack of authorized shares, it was determined that the conversion feature was not afforded the exemption as a conventional convertible instrument and did not otherwise meet the conditions for equity classification. As such, the conversion and other features were compounded into one instrument, bifurcated from the debt instrument and carried as a derivative liability, at fair value. The Company estimated the fair value of the

bifurcated derivative instruments using the Monte Carlo valuation model because this methodology provides for all of the necessary assumptions necessary for fair value determination; including assumptions for credit risk, interest risk and conversion/redemption behavior. Significant assumptions underlying this methodology were: effective term (using the remaining term of the host instrument); effective volatility (132.38%); and effective risk adjusted yield (12.5%). As a result of these estimates, the valuation model resulted in a compound derivative balance of \$100,880 at inception. Derivative expense of \$35,880 was recognized at inception.

There were no conversions on this convertible debenture during the three months ended September 30, 2011.

COROWARE, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

(l) \$15,000 Panache financing:

On April 2, 2011, the Company entered into a \$15,000 Convertible Note Agreement with an unrelated third party (“Panache”). The note calls for interest at 8% through the maturity date of June 29, 2012. The note can be renewed for an additional 10 years under 6 month extensions at \$100 per extension.

The holder of the debenture may, at any time, convert amounts outstanding under the debenture into shares of common stock of the Company at a conversion rate equal to an agreed to discount to market not to fall below a 15% discount to the average of the 3 lowest trading prices during the 20 days prior to conversion.

In the Company’s evaluation of this instrument in accordance with ASC 815 Derivatives and Hedging, based on the variable conversion price and lack of authorized shares, it was determined that the conversion feature was not afforded the exemption as a conventional convertible instrument and did not otherwise meet the conditions for equity classification. As such, the conversion and other features were compounded into one instrument, bifurcated from the debt instrument and carried as a derivative liability, at fair value. The Company estimated the fair value of the bifurcated derivative instruments using the Monte Carlo valuation model because this methodology provides for all of the necessary assumptions necessary for fair value determination; including assumptions for credit risk, interest risk and conversion/redemption behavior. Significant assumptions underlying this methodology were: effective term (using the remaining term of the host instrument); effective volatility (132.38%); and effective risk adjusted yield (12.5%). As a result of these estimates, the valuation model resulted in a compound derivative balance of \$13,500 at inception.

As of September 30, 2011, there have been no conversions on this convertible debenture.

(m) \$567,200 Westmount financing:

On April 12, 2011, Yorkville assigned 100% of Tranche 2 of its \$2,825,000 debenture (aggregating \$567,200 in principal and \$317,510 in interest) to an unrelated third party (“Westmount”). The terms of the note did not change. As such, there was no accounting impact for CoroWare as it was merely an assignment between debt holders. The note calls for interest at 14%. This note matured August 22, 2009 and is currently in default.

The holder of the debenture may, at any time, convert amounts outstanding under the debenture into shares of common stock of the Company at a conversion rate equal to 85% of the lowest volume weighted average price in the 30 days prior to the conversion date. The Company's obligations under the purchase agreement are secured by substantially all of the assets of the Company and those of its wholly owned subsidiary, CoroWare Technologies, Inc.

During the three months ending September 30, 2011, there were no conversions on this convertible debenture.

(n) \$170,561 Redwood financing:

On March 21, 2011, Ratzker (see Note 5(e)) transferred 50% of his ownership interest in his convertible debenture to another unrelated party (“Redwood”). The terms of the note did not change. As such, there was no accounting impact for CoroWare as it was merely an assignment between debt holders. The note calls for interest at 5% through the maturity date of March 18, 2013.





COROWARE, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

The holder of the debenture may, at any time, convert amounts outstanding under the debenture into shares of common stock of the Company at a conversion rate equal to 65% of the volume weighted average price for the Company's stock for the 30 trading days prior to conversion. The Company's obligations under the purchase agreement are secured by substantially all of the assets of the Company and those of its wholly owned subsidiary, CoroWare Technologies, Inc.

During the three months ending September 30, 2011, there were no conversions on this convertible debenture.

The following tables illustrate the fair value adjustments that were recorded related to the derivative financial instruments associated with the convertible debenture financings:

	Three Months ended September 30, 2011			
	Inception	Fair Value Adjustments	Redemptions	Total
Derivative income (expense):				
\$2,825,000 Yorkville financing (a)	\$-	\$ (550,989 )	\$ -	\$(550,989 )
\$ 600,000 Yorkville financing	-	(797,107 )	-	(797,107 )
\$ 300,000 Yorkville financing	-	-	-	-
\$ 75,000 Collins financing	-	(40,046 )	-	(40,046 )
\$ 27,500 Asher financing (b)	-	(20,294 )	(2,976 )	(23,270 )
\$ 10,750 Barclay financing (c)	-	(2,829 )	-	(2,829 )
\$ 9,750 Mackie financing (d)	-	(900 )	-	(900 )
\$ 170,562 Ratzker financing (e)	-	(97,539 )	-	(97,539 )
\$ 67,042 Harvey financing (f)	-	(11,839 )	-	(11,839 )
\$ 89,383 Cariou financing (g)	-	(7,299 )	-	(7,299 )
\$ 25,000 Tangiers financing (h)	-	-	-	-
\$ 10,000 Tangiers financing (i)	-	(3,009 )	-	(3,009 )
\$ 15,000 Tangiers financing (j)	-	(8,292 )	-	(8,292 )
\$ 65,000 Panache financing (k)	-	(86,638 )	-	(86,638 )
\$ 15,000 Panache financing (l)	-	(11,395 )	-	(11,395 )
\$ 567,200 Westmount financing (m)	-	(561,796 )	-	(561,796 )
\$ 170,561 Redwood financing (n)	-	(60,934 )	-	(60,934 )
Preferred stock, Series B	-	(298,043 )	-	(298,043 )
	\$-	\$ (2,558,949 )	\$ (2,976 )	\$(2,561,925 )

	Three Months ended September 30, 2010			
	Inception	Fair Value Adjustments	Redemptions	Total
Derivative income (expense):				
\$2,825,000 financing	\$-	\$ (678,756 )	\$ (3,556 )	\$(682,312 )
\$ 600,000 financing	-	(254,487 )	-	(254,487 )
\$ 300,000 financing	-	(183 )	-	(183 )
Preferred stock, Series B	-	13,312	-	13,312
	\$-	\$ (920,114 )	\$ (3,556 )	\$(923,670 )

COROWARE, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

Nine Months ended September 30, 2011

Derivative income (expense):	Inception	Fair Value		Total
		Adjustments	Redemptions	
\$2,825,000 Yorkville financing (a)	\$-	\$ (244,386 )	\$ (23,917 )	\$(268,303 )
\$ 600,000 Yorkville financing	-	(599,854 )	-	(599,854 )
\$ 300,000 Yorkville financing	-	26	-	26
\$ 75,000 Collins financing	-	(35,461 )	(22,742 )	(58,203 )
\$ 27,500 Asher financing (b)	(9,229 )	(24,483 )	(2,976 )	(36,688 )
\$ 10,750 Barclay financing (c)	(1,619 )	(1,844 )	-	(3,463 )
\$ 9,750 Mackie financing (d)	-	(2,288 )	-	(2,288 )
\$ 170,562 Ratzker financing (e)	-	(138,784 )	-	(138,784 )
\$ 67,042 Harvey financing (f)	-	(12,330 )	-	(12,330 )
\$ 89,383 Cariou financing (g)	-	(3,420 )	-	(3,420 )
\$ 10,000 Tangiers financing (i)	-	(12,624 )	-	(12,624 )
\$ 15,000 Tangiers financing (j)	-	(20,579 )	-	(20,579 )
\$ 25,000 Tangiers financing (h)	(1,662 )	22,462	-	20,800
\$ 65,000 Panache financing (k)	(35,880 )	(63,178 )	(11,352 )	(110,410 )
\$ 15,000 Panache financing (l)	-	(7,559 )	-	(7,559 )
\$ 567,200 Westmount financing (m)	-	(1,091,001 )	(42,054 )	(1,133,055)
\$ 170,561 Redwood financing (n)	-	(402,840 )	(67,492 )	(470,332 )
Preferred stock, Series B	-	(164,817 )	-	(164,817 )
	\$(48,390 )	\$ (2,802,960 )	\$ (170,533 )	\$(3,021,883)

Nine Months ended September 30, 2010

Derivative income (expense)	Inception	Fair Value		Total
		Adjustments	Redemptions	
\$2,825,000 financing	\$-	\$ 6,668	\$ (30,709 )	\$(24,041 )
\$ 600,000 financing	-	13,073	-	13,073
\$ 300,000 financing	-	1,330	-	1,330
Preferred stock, Series B	-	86,410	-	86,410
	\$-	\$ 107,481	\$ (30,709 )	\$76,772

COROWARE, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

The following table illustrates the components of derivative liabilities:

	As of September 30, 2011		
	Compound Derivative	Warrant Liability	Total
\$2,825,000 Yorkville financing (a)	\$ 1,220,301	\$-	\$ 1,220,301
\$ 600,000 Yorkville financing	969,963	2,625	972,588
\$ 300,000 Yorkville financing	-	-	-
\$ 75,000 Collins financing	73,696	-	73,696
\$ 27,500 Asher financing (b)	61,212	-	61,212
\$ 10,750 Barclay financing (c)	14,213	-	14,213
\$ 9,750 Mackie financing (d)	5,778	-	5,778
\$ 170,562 Ratzker financing (e)	395,855	-	395,855
\$ 67,042 Harvey financing (f)	42,341	-	42,341
\$ 89,383 Cariou financing (g)	48,140	-	48,140
\$ 10,000 Tangiers financing (i)	18,501	-	18,501
\$ 15,000 Tangiers financing (j)	31,379	-	31,379
\$ 65,000 Panache financing (k)	164,058	-	164,058
\$ 15,000 Panache financing (l)	21,059	-	21,059
\$ 567,200 Westmount financing (m)	1,312,178	-	1,312,178
\$ 170,561 Redwood financing (n)	524,611	-	524,611
	\$4,903,285	\$2,625	\$4,905,910

	As of December 31, 2010		
	Compound Derivative	Warrant Liability	Total
\$2,825,000 financing	\$ 1,414,222	\$6	\$ 1,414,228
\$ 600,000 financing	366,434	6,300	372,734
\$ 300,000 financing	-	27	27
\$ 75,000 financing	38,227	-	38,227
	\$ 1,818,883	\$ 6,333	\$ 1,825,216

COROWARE, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

The following table summarizes the number of common shares indexed to the derivative financial instruments as of September 30, 2011:

Financing or other contractual arrangement:	Conversion		
	Features	Warrants	Total
\$2,825,000 Yorkville financing (a)	10,500,340,734	-	10,500,340,734
\$ 600,000 Yorkville financing	10,892,634,972	26,250,000	10,918,884,972
\$ 300,000 Yorkville financing	74,395	33,333	107,728
\$ 75,000 Collins financing	635,309,452	-	635,309,452
\$ 27,500 Asher financing (b)	527,689,498	-	527,689,498
\$ 10,750 Barclay financing (c)	122,529,384	-	122,529,384
\$ 9,750 Mackie financing (d)	62,809,426	-	62,809,426
\$ 170,562 Ratzker financing (e)	2,889,446,053	-	2,889,446,053
\$ 67,042 Harvey financing (f)	460,228,995	-	460,228,995
\$ 89,383 Cariou financing (g)	523,268,010	-	523,268,010
\$ 10,000 Tangiers financing (i)	159,494,204	-	159,494,204
\$ 15,000 Tangiers financing (j)	237,723,920	-	237,723,920
\$ 65,000 Panache financing (k)	1,188,827,397	-	1,188,827,397
\$ 15,000 Panache financing (l)	179,990,330	-	179,990,330
\$ 567,200 Westmount financing (m)	10,497,423,929	-	10,497,423,929
\$ 170,561 Redwood financing (n)	3,857,426,259	-	3,857,426,259
	42,735,216,958	26,283,333	42,761,500,291

The embedded conversion features associated with our convertible debentures are valued based on the number of shares that are indexed to that liability. Keeping the number of shares constant, the liability associated with the embedded conversion features increases as our share price increases and, likewise, decreases when our share price decreases. In the same manner, derivative expense is created when our share price increases and derivative income is created when our share price decreases.

During the nine months ended September 30, 2011, conversions were as follows:

Financing or other contractual arrangement:	Principal converted	Shares Issued	Gain (Loss) Recorded
\$2,825,000 Yorkville convertible note financing	\$50,170	55,536,746	\$31,871
\$ 75,000 Collins convertible note financing	26,530	41,000,000	1,101
\$ 27,500 Asher convertible note financing	2,000	33,333,333	114
\$ 25,000 Tangiers convertible note financing	25,000	96,153,846	(30,769 )
\$ 65,000 Panache convertible note financing	8,400	42,000,000	10,092
\$ 567,200 Westmount convertible note financing	29,883	66,682,665	34,965
\$ 170,561 Redwood convertible note financing	36,700	101,666,663	28,143
	\$178,683	436,373,253	\$75,517

COROWARE, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

As noted above, the following notes are in default: the remaining balance of the \$2,825,000 financing, the \$600,000 and \$300,000 Yorkville financings, the \$75,000 Collins financing, the \$27,500 Asher financing, the \$10,750 Barclay financing, the \$9,750 Mackie financing, the \$567,200 Westmount financing, the \$67,042 Harvey financing, and the \$89,383 Cariou financing. However, the terms of the agreements allow conversion of the debt during periods of default. In computing the derivative liability associated with the conversion, one of the inputs is maturity of the instruments which, in this case, is technically in the past. Accordingly, management has estimated a debt maturity date of ten months from the period-end date for purposes of the derivative liability calculations.

NOTE 6 - OTHER STOCKHOLDERS' EQUITY

a) Stock Options:

The following table summarizes stock option activity:

	Total Options	Weighted Average Price
Outstanding, December 31, 2010	38,164	\$2.97
Granted	-	-
Cancelled	-	-
Forfeited	-	-
Exercised	-	-
Outstanding, September 30, 2011	38,164	\$2.97
Exercisable at September 30, 2011	38,164	\$2.97

b) Outstanding warrants:

At September 30, 2011, the Company had the following warrants outstanding:

	Grant Date	Expiration Date	Warrants Granted	Exercise Price
\$ 300,000 financing	03/19/08	03/19/13	33,333	\$6.00

c) Issuance of common stock:

The following table summarizes common stock issued for services during the nine month period ended September 30:

	2011		2010	
	Shares	Value	Shares	Value
Employee compensation	1,000,000	\$3,300	2,176,700	\$65,867
Professional fees	-	-	692,318	\$23,717
	1,000,000	\$3,300	2,869,018	\$89,584

COROWARE, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

The following table summarizes other common stock issued during the nine month period ended September 30:

	2011		2010	
	Shares	Value	Shares	Value
Satisfaction of payables	196,789,147	\$280,851	4,889,015	\$139,461
Redemption of convertible debenture	509,738,090	330,669	3,922,107	101,609
	706,527,237	\$611,520	8,811,122	\$241,070

As a result of the issuances noted above, substantial dilution of existing stockholders' interests has occurred.

d) Dividends on preferred stock:

At September 30, 2011 and December 31, 2010, there were cumulative undeclared dividends to Preferred Series B shareholders of \$37,921 and \$31,933, respectively, the obligation for which is contingent on declaration by the board of directors.

NOTE 7 – COMMITMENTS

The Company leases its principal operating facilities in Kirkland, Washington under a 5 year operating lease which provides for monthly payments of \$3,735 with a built in annual escalation clause increasing monthly rent by \$249 at each anniversary date.

Future non-cancelable minimum lease payments are as follows:

Years Ending December 31,	
2011	27,390
2012	49,053
2013	52,041
2014	55,029
2015	33,117
	\$216,630

NOTE 8 – Subsequent Events

On November 16, 2011, the Company filed an SEC Form 8-K, Report of Unscheduled Material Events or Corporate Changes, stating that the Company entered into Series D Preferred Stock Recipient Agreements with three investors. The total amount of Corporation indebtedness to the Series D holders and forgiven by them amounted to \$100,000.

On November 16, 2011, the Company filed an SEC Form PRE 14C, Notice Of Stockholder Action By Written Consent, authorizing an increase in the number of authorized shares of Common Stock from nine hundred million (900,000,000) shares of Common Stock to three billion (3,000,000,000) shares of Common Stock; and amending the par value of Common Stock from a par value \$0.001 per share to a par value \$0.0001 per share.

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

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as "may" "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential" or "continue," the negative of such terms, or other comparable terminology. These statements are only predictions. Actual events or results may differ materially from those in the forward-looking statements as a result of various important factors. Although we believe that the expectations reflected in the forward-looking statements are reasonable, they should not be regarded as a representation by CoroWare, Inc., or any other person, that such expectations will be achieved. The business and operations of CoroWare, Inc. are subject to substantial risks, which increase the uncertainty inherent in the forward-looking statements contained in this report.

### BACKGROUND

CoroWare, Inc ("CoroWare" or "the Company") is a public holding company whose principal subsidiary, CoroWare Technologies, Inc. ("CTI"), has expertise in information technology consulting, mobile robotics, and affordable telepresence. Through its subsidiary, the Company delivers custom engineering services, hardware and software products, and subscription services that benefit customers in North America, Europe, Asia and the Middle East. Their customers span multiple industry sectors and are comprised of universities, software and hardware product development companies, and non-profit organizations. The company also maintains a Near Shore practice which is comprised of multiple subcontracting companies with whom the company maintains close working relationships. Through these relationships, the Company is able to provide services in South America.

### COROWARE TECHNOLOGIES, INC.

CTI is a software professional services company with a strong focus on Information Technology integration and robotics integration, business automation solutions, and unmanned systems solutions to its customers in North America and Europe.

CTI's expertise includes the deployment and integration of computing platforms and applications, as well as the development of unmanned vehicle software and solutions for customers in the research, commercial, and homeland security market segments. CTI shall continue to offer its high value software systems development and integration services that complement the growing trend in outsourced software development services in Asia, Latin America, and Eastern Europe.

CoroWare Technologies comprises three separately managed lines of business:

- CoroWare Business Solutions: IT and lab management; software architecture, design and development; content delivery; partner and program management.
- Robotics and Automation: Custom engineering such as visualization, simulation and software development; and mobile robot platforms for university, government and corporate researchers.
  - Telepresence: High definition video conferencing products, solutions and subscription services.

The Company's revenues are principally derived from standing contracts that include Microsoft (partner management and IT professional services), a European auto manufacturer (simulation software custom development), and other customers whose product development groups require custom software development and consulting companies. Existing contract revenues vary month by month based on the demands of the clients. The Company's telepresence effort is in the early stages of growth and will require additional working capital to compete effectively against new



entrants in this rapidly growing market.

-21-

---

## RESULTS OF OPERATIONS

### THREE MONTHS ENDED SEPTEMBER 30, 2011 COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 2010:

During the three-month period ended September 30, 2011 (the "2011 Period") revenues were \$389,089 compared to revenues of \$376,648 during the three-month period ended September 30, 2010 (the "2010 Period"). Our revenues were flat compared to the previous year as customers reduced spending on software development services for billing integration, custom engineering, and IT consulting projects in the summer months; purchased CoroCall hosted services instead of videoconferencing infrastructure and room systems; and delayed spending on mobile robotics projects until later in the calendar year.

Cost of revenues was \$289,945 for the 2011 Period compared to \$243,621 for the 2010 Period. Cost of revenues represents primarily labor and labor-related costs in addition to overhead costs. Gross profit on these 2011 revenues amounted to \$99,144 (25.5% gross profit percentage) compared to \$133,027 (35.3% gross profit percentage) for the 2010 Period. The reduced gross profit percentage resulted from additional personal time off (PTO) and unanticipated project warranty expenses.

Research and development was \$20,372 (5.2% of gross revenues) for the 2011 Period compared to \$51,097 (13.6% of gross revenues) in the 2010 Period. The decreased research and development investment resulted from completing our software development and testing initiatives, including CoroCall Communications Cloud Service and CoroWare Billing Integration Framework.

Operating expenses were \$274,784 during the 2011 Period compared to \$479,376 during the 2010 Period. Sales and marketing were lower in the 2011 Period as the Company adjusted sales compensation plans to bring them in line with the Company's cost of sales objectives. Loss from operations was \$175,640 during the 2011 Period compared to \$346,349 in the 2010 Period.

Total other expense was \$2,760,329 during the 2011 Period compared to a loss of \$1,061,716 in the 2010 Period. Other income (expense) is comprised primarily of derivative income and amortization of debt discount and deferred finance costs. Derivative expense in the 2011 Period was \$2,561,925 compared to derivative expense of \$923,670 in the 2010 Period. Derivative expense increased in the 2011 period with the addition of new convertible debentures in addition to the modifications made to certain notes payable which triggered derivative treatment. Interest expense for the three month 2011 Period is \$198,518 compared to \$142,061 for the three month 2010 Period. The debt discount was amortized using the effective interest method. Under this method, the amount of amortization increased exponentially as the underlying carrying value of the amortized debt increased.

Net Loss for the 2011 Period was \$2,935,969 compared to a net loss of \$1,408,065 for the 2010 Period.

### NINE MONTHS ENDED SEPTEMBER 30, 2011 COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 2010:

During the nine-month period ended September 30, 2011 (the "2011 Period") revenues were \$1,277,358 compared to revenues of \$1,555,270 during the nine-month period ended September 30, 2010 (the "2010 Period"). Our revenues decreased compared to the previous year as sales of videoconferencing infrastructure and room systems shifted toward CoroCall hosted services; and delayed spending on software development services for billing integration, custom engineering, and IT consulting projects.

Cost of revenues was \$849,347 for the 2011 Period compared to \$1,176,497 for the 2010 Period. Cost of revenues represents primarily labor and labor-related costs in addition to overhead costs. Gross profit on these 2011 revenues amounted to \$428,011 (33.5% gross profit percentage) compared to \$378,773 (24.4% gross profit percentage) for the 2010 Period.

Research and development was \$106,562 (8.3% of gross revenues) for the 2011 Period compared to \$86,904 (5.6% of gross revenues) in the 2010 Period.

Operating expenses were \$1,036,048 during the 2011 Period compared to \$1,120,619 during the 2010 Period. Sales and marketing expenses were slightly lower in the 2011 Period as the Company invested in sales and marketing initiatives in the first 6 months of the year to help increase major account sales of CoroCall and CoroWare's telepresence product sales in the coming months, and then adjusted sales compensation plans in the 3rd quarter to bring them in line with the Company's cost of sales objectives

Loss from operations was \$608,037 during the 2011 Period compared to \$741,846 in the 2010 Period.

Total other expense was \$3,590,548 during the 2011 Period compared to total other expense of \$416,112 in the 2010 Period. Other income expense is comprised primarily of derivative income (expense) and amortization of debt discount and deferred finance costs. Derivative expense in the 2011 Period was \$3,021,883 compared to a derivative income of \$76,772 in the 2010 Period. The embedded conversion features associated with our convertible debentures are valued based on the number of shares that are indexed to that liability. Keeping the number of shares constant, the liability associated with the embedded conversion features increases as our share price increases and, likewise, decreases when our share price decreases. Derivative income (expense) displays the inverse relationship. Derivative expense increased in the 2011 period with the addition of new convertible debentures in addition to the modifications made to certain notes payable which triggered derivative treatment. Interest expense for the 2011 Period was \$567,600 compared to \$559,615 for the 2010 Period.

Net Loss for the 2011 Period was \$4,198,586 compared to a net loss of \$1,157,958 for the 2010 Period.

Basic weighted average shares outstanding were 498,096,006 during the 2011 Period compared to 15,356,860 in the 2010 Period. There is no fully diluted calculation for the 2011 Period or the 2010 Period as the effect would be anti-dilutive.

## LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2011, we had current assets of \$186,880, current liabilities of \$13,532,153, negative working capital of (\$13,345,273) and an accumulated deficit of \$29,636,555. For the nine months ending September 30, 2011, we had net cash flows used in operating activities of (\$57,922) and net cash flows provided by financing activities of \$78,162.

We will need to obtain additional capital in order to expand operations and become profitable. In order to obtain capital, we may need to sell additional shares of our common stock or borrow funds from private lenders. There can be no assurance that we will be successful in obtaining additional funding. We will still need additional capital in order to continue operations until we are able to achieve positive operating cash flow. Additional capital is being sought, but we cannot guarantee that we will be able to obtain such investments. Financing transactions may include the issuance of equity or debt securities, obtaining credit facilities, or other financing mechanisms. If we do not obtain additional capital, we may cease operations.

However, even if we are able to raise the funds required, it is possible that we could incur unexpected costs and expenses, fail to collect significant amounts owed to us, or experience unexpected cash requirements that would force us to seek alternative financing. Furthermore, if we issue additional equity or debt securities, stockholders may experience additional dilution or the new equity securities may have rights, preferences or privileges senior to those of existing holders of our common stock. If additional financing is not available or is not available on acceptable terms, we will have to curtail our operations.

OFF-BALANCE SHEET ARRANGEMENTS

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

## CONTRACTUAL OBLIGATIONS

The following table sets forth the contractual obligations of the Company as of December 31, 2010:

Contractual Obligations	Total	Payments due by Period			
		Less than 1 year	1-3 years	3-5 years	More than 5 years
Convertible debt, net	\$2,292,410	\$2,292,410	\$-	\$-	\$-
Notes payable	263,133	263,133	-	-	-
Notes payable, related parties	292,812	292,812	-	-	-
Operating leases	235,305	46,065	101,094	88,146	-
Long-term debt	982,450	982,450	-	-	-
Total	\$4,066,110	\$3,876,870	\$101,094	\$88,146	\$-

## EFFECT OF RECENT ACCOUNTING PRONOUNCEMENTS

Refer to Form 10-K for the year ended December 31, 2010.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company, as defined in Rule 12b-2 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), we are not required to provide the information required by this item.

## ITEM 4. CONTROLS AND PROCEDURES

## Evaluation of Disclosure Controls and Procedures

With the participation of Lloyd T. Spencer, who serves as the Chief Executive Officer (the principal executive officer) and Interim Chief Financial Officer (the principal financial officer); the Company's management has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of the end of the quarterly period covered by this Quarterly Report on Form 10-Q. As of the end of the period covered by this Report, we conducted an evaluation, under the supervision and with the participation of our chief executive officer and interim chief financial officer, of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Based on this evaluation, our chief executive officer and interim chief financial officer concluded that our disclosure controls and procedures are not effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. The ineffectiveness of our disclosure controls and procedures is the result of certain deficiencies in internal controls constituting material weaknesses as discussed below.

The Company has historically had limited operating revenue and, as such, all accounting and financial reporting operations have been and are currently performed by a limited number of individuals. The parties that perform the accounting and financial reporting operations are the only parties with any significant knowledge of generally accepted accounting principles. Thus, we lack segregation of duties in the period-end financial reporting process. This lack of additional accounting/auditing staff with significant knowledge of generally accepted accounting principles in order to properly segregate duties could result in ineffective oversight and monitoring and the possibility of a misstatement within the consolidated financial statements. However, the material weaknesses identified did not result in the restatement of any previously reported financial statements or any other related financial disclosure, nor does management believe that it had any effect on the accuracy of the Company's consolidated financial statements for the

current reporting period.

The Company is currently reviewing its policies and is evaluating its disclosure controls and procedures so that it will be able to determine the changes it can and should make to make such controls more effective.

#### Changes in Internal Controls over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the Company's last fiscal quarter that have materially affected, or are likely to materially affect, the Company's internal control over financial reporting.

Part II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 1A. RISK FACTORS

As a smaller reporting company, as defined in Rule 12b-2 of the Exchange Act, we are not required to provide the information required by this item.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

- (a) No material default in the payment of principal, interest, a sinking fund or purchase fund installment, or any other material default not cured within 30 days exists as of the balance sheet date.
- (b) As of the balance sheet date the company is in arrears in the payment of dividends related to its Series B preferred stock in the amount of \$15,969.
- (c) At September 30, 2011, we are in default on the remaining of the original \$2,825,000 Secured Convertible Debenture presently held by Yorkville Advisors, LLC. Yorkville currently holds \$395,628 of the first tranche and \$82,630 of the third tranche. The remainder of the first tranche was assigned to a third party (“Ratzker”) who amended the terms in March 2011 extending the maturity date to March 2013. During the second quarter of 2011, Ratzker assigned 50% of his note to another third party (“Redwood”). The second tranche was assigned to a third party who did not amend the terms. The note is still in default. The debenture accrued interest at 10% per annum thru March 25, 2008 at which time the interest rate was increased to 14% per annum. The debenture is convertible at the option of the holder into shares of CoroWare, Inc. common stock.
- (d) As of September 30, 2011, we are in default on our Secured Convertible Debenture presently held by Yorkville Advisors, LLC in the face amount of \$600,000. The debenture accrued interest at 14% per annum and is convertible at the option of the holder into shares of CoroWare, Inc. common stock.
- (e) As of September 30, 2011, we are in default on our Secured Convertible Debenture presently held by Yorkville Advisors, LLC in the face amount of \$300,000. The debenture accrued interest at 14% per annum and is convertible at the option of the holder into shares of CoroWare, Inc. common stock.
- (f) As of September 30, 2011, we are in default on our Unsecured Convertible Debenture presently held by Barclay Lyons in the face amount of \$10,750. The debenture accrued interest at 21% through the maturity date of July 28, 2011 with default interest at 35% thereafter. The debenture is convertible at the option of the holder into shares of CoroWare, Inc. common stock.
- (g) As of September 30, 2011, we are in default on our Unsecured Convertible Debenture presently held by Robert Mackie in the face amount of \$9,750. The debenture accrued interest at 15% through the maturity date of February 18, 2011 with default interest at 20% thereafter. The debenture is convertible at the option of the holder into shares of CoroWare, Inc. common stock.



- (h) As of September 30, 2011, we are in default on our Unsecured Convertible Debenture presently held by Martin Harvey in the face amount of \$67,042. The debenture accrued interest at 10% through the maturity date of May 2, 2011 with default interest at 15% thereafter. The debenture is convertible at the option of the holder into shares of CoroWare, Inc. common stock.
- (i) As of September 30, 2011, we are in default on our Unsecured Convertible Debenture presently held by Thomas Collins in the face amount of \$39,170. The debenture accrues interest at 15% and is convertible at the option of the holder into shares of CoroWare, Inc. common stock.

- (j) As of September 30, 2011, we are in default on two notes payable aggregating \$100,000. The notes accrued interest at 8% through the maturity date of February 2003 with default interest at 15% thereafter. The notes are convertible at the option of the holder into shares of CoroWare, Inc. common stock.

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

Removed and Reserved.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

- 31    Certification of Periodic Financial Reports by Lloyd Spencer in satisfaction of Section  
    302 of the Sarbanes-Oxley Act of 2002
- 32    Certification of Periodic Financial Reports by Lloyd Spencer in satisfaction of Section  
    906 of the Sarbanes-Oxley Act of 2002 and 18 U.S.C. Section 1350

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.

CoroWare, Inc.

Dated: November 21, 2011

By: /s/ Lloyd T. Spencer  
Lloyd T. Spencer  
Chief Executive Officer and  
Interim Chief Financial Officer  
(Principal Executive Officer and  
Principal  
Accounting and Financial Officer)

