

CoroWare, Inc,  
Form 10-Q  
November 22, 2010

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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, 2010

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

1410 Market Street, Suite 200  
Kirkland, WA 98033  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(800) 641-2676  
(ISSUERREGISTRANT 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 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.

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

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 19, 2010 there were 52,451,315 shares of the issuer's \$.001 par value common stock issued and outstanding.

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COROWARE, INC.  
September 30, 2010 QUARTERLY REPORT ON FORM 10-Q

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## PART I – FINANCIAL INFORMATION

## ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

COROWARE, INC.  
CONSOLIDATED BALANCE SHEETS

|  | September 30, 2010<br>(Unaudited) | December<br>31, 2009 |
|--|-----------------------------------|----------------------|
| <b>ASSETS</b>  |                                   |                      |
| Current assets:  |                                   |                      |
| Cash   | \$ -                              | \$3,493              |
| Accounts receivable, net   | 123,892                           | 189,115              |
| Other current assets   | 15,105                            | 35,651               |
| Total current assets   | 138,997                           | 228,259              |
| Property and equipment, net  | 35,995                            | 47,395               |
| Intangible assets, net   | 17,731                            | 37,681               |
| Other assets, net  | 4,731                             | 4,815                |
| Deferred financing costs, net  | -                                 | 6,250                |
| <b>TOTAL ASSETS</b>  | <b>\$ 197,454</b>                 | <b>\$324,400</b>     |
| <b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>   |                                   |                      |
| Current liabilities:   |                                   |                      |
| Lines of credit  | \$ 125,083                        | \$123,696            |
| Accounts payable and accrued expenses  | 3,745,147                         | 2,968,131            |
| Accrued expenses, related parties  | 142,175                           | 88,438               |
| Notes payable  | 334,232                           | 357,732              |
| Notes payable, related parties   | 378,976                           | 408,229              |
| Derivative liability   | 2,227,725                         | 2,249,038            |
| Convertible debt, net of discount  | 2,340,933                         | 2,424,391            |
| Redeemable preferred stock, Series B, \$.001 par value,<br>10,000,000<br>shares authorized, 159,666 shares issued and<br>outstanding as of<br>September 30, 2010 and December 31, 2009 | 187,841                           | 274,251              |
| Long-term debt   | 982,450                           | 989,100              |
| Total current liabilities  | 10,464,562                        | 9,883,006            |
| Total liabilities  | 10,464,562                        | 9,883,006            |
| <b>Commitments</b>   |                                   |                      |
| <b>Stockholders' deficit:</b>  |                                   |                      |
| Common stock, \$.001 par value, 900,000,000 shares<br>authorized,<br>27,673,575 and 4,506,191 shares issued and<br>outstanding at  |                                   |                      |

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|   |                   |                  |
|---|-------------------|------------------|
| September 30, 2010 and December 31, 2009,<br>respectively | 27,674            | 4,506            |
| Additional paid-in capital                                | 15,327,961        | 14,901,673       |
| Accumulated deficit                                       | (25,587,043 )     | (24,429,085)     |
| Treasury stock  | (35,700 )         | (35,700 )        |
| Total stockholders' deficit                               | (10,267,108 )     | (9,558,606 )     |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS'<br/>DEFICIT</b>    | <b>\$ 197,454</b> | <b>\$324,400</b> |

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

COROWARE, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
For the Three and Nine Months Ended September 30, 2010 and 2009  
(Unaudited)

|                                      | Three Months Ended<br>September 30, |              | Nine Months Ended<br>September 30, |               |
|--------------------------------------|-------------------------------------|--------------|------------------------------------|---------------|
|                                      | 2010                                | 2009         | 2010                               | 2009          |
| Revenues                             | \$376,648                           | \$386,903    | \$1,555,270                        | \$1,461,009   |
| Cost of revenues                     | 243,621                             | 313,723      | 1,176,497                          | 982,800       |
| Gross profit                         | 133,027                             | 73,180       | 378,773                            | 478,209       |
| Operating expenses:                  |                                     |              |                                    |               |
| General and administrative           | 241,093                             | 264,325      | 730,606                            | 657,531       |
| Sales and marketing                  | 176,636                             | 38,494       | 271,759                            | 104,618       |
| Research and development             | 51,097                              | -            | 86,904                             | 87            |
| Depreciation and amortization        | 10,550                              | 10,297       | 31,350                             | 119,767       |
| Total operating expenses             | 479,376                             | 313,116      | 1,120,619                          | 882,003       |
| Loss from operations                 | (346,349 )                          | (239,936 )   | (741,846 )                         | (403,794 )    |
| Other income (expense):              |                                     |              |                                    |               |
| Derivative income (expense)          | (923,670 )                          | 654,399      | 76,772                             | (1,622,863)   |
| Interest expense, net                | (142,061 )                          | (1,026,141)  | (559,615 )                         | (2,016,069)   |
| Other income                         | -                                   | -            | 30,156                             | -             |
| Gain on debt redemptions             | 4,015                               | -            | 36,575                             | -             |
| Total other income (expense)         | (1,061,716 )                        | (371,742 )   | (416,112 )                         | (3,638,932)   |
| Net loss                             | \$(1,408,065 )                      | \$(611,678 ) | \$(1,157,958 )                     | \$(4,042,726) |
| Net loss per share:                  |                                     |              |                                    |               |
| Basic                                | \$(0.06 )                           | \$(0.21 )    | \$(0.08 )                          | \$(1.38 )     |
| Diluted                              | \$(0.06 )                           | \$(0.21 )    | \$(0.08 )                          | \$(1.38 )     |
| Weighted average shares outstanding: |                                     |              |                                    |               |
| Basic                                | 24,634,725                          | 2,953,870    | 15,356,860                         | 2,931,369     |
| Diluted                              | 24,634,725                          | 2,953,870    | 15,356,860                         | 2,931,369     |

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, 2010 and 2009  
(Unaudited)

|   | 2010                 | 2009                 |
|---|----------------------|----------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                       | <b>\$(1,157,958)</b> | <b>\$(4,042,726)</b> |
| Net loss  |                      |                      |
| Adjustments to reconcile net loss to net cash flows<br>from operating activities: |                      |                      |
| Depreciation and amortization   | 31,350               | 119,767              |
| Stock option expense  | 19,313               | 40,075               |
| Amortization of debt discount   | 59,444               | 1,776,676            |
| Amortization of deferred financing costs  | 6,250                | 107,186              |
| Derivative (income) loss  | (76,772 )            | 1,622,863            |
| Gain on debt redemptions  | (47,724 )            | (6,453 )             |
| Common stock issued for services  | 132,037              | 9,418                |
| Write off software development costs  | -                    | 35,842               |
| Changes in operating assets and liabilities:                                      |                      |                      |
| Accounts receivable, net  | 65,223               | (64,178 )            |
| Other current assets, net   | 20,630               | 951                  |
| Accounts payable and accrued expenses   | 305,052              | 34,723               |
| Accrued expenses, related parties   | 683,328              | 58,363               |
| <b>NET CASH FLOWS FROM OPERATING ACTIVITIES</b>                                   | <b>40,173</b>        | <b>(307,493 )</b>    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                       |                      |                      |
| Additions to property and equipment   | -                    | (33,625 )            |
| <b>NET CASH FLOWS FROM INVESTING ACTIVITIES</b>                                   | <b>-</b>             | <b>(33,625 )</b>     |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                       |                      |                      |
| Proceeds from lines of credit, net  | 1,387                | 95,161               |
| Payments on notes payable   | (70,000 )            | (5,268 )             |
| Payments on notes payable, related party  | (35,053 )            | (30,000 )            |
| Proceeds from notes payable   | 40,000               | 500                  |
| Proceeds from notes payable, related party  | 20,000               | 248,629              |
| <b>NET CASH FLOWS FROM FINANCING ACTIVITIES</b>                                   | <b>(43,666 )</b>     | <b>309,022</b>       |
| <b>NET DECREASE IN CASH</b>   | <b>(3,493 )</b>      | <b>(32,096 )</b>     |
| Cash, beginning of period   | 3,493                | 32,142               |
| Cash, end of period   | \$-                  | \$46                 |

Continued.

COROWARE, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)  
For the Nine Months Ended September 30, 2010 and 2009  
(Unaudited)

|  | 2010      | 2009     |
|--|-----------|----------|
| <b>SUPPLEMENTAL CASH FLOW INFORMATION</b>                    |           |          |
| Interest paid  | \$1,000   | \$24,065 |
| Income taxes paid  | \$-       | \$-      |
| <b>NON-CASH INVESTING AND FINANCING TRANSACTIONS</b>         |           |          |
| Common stock issued for redemption of convertible debentures | \$118,569 | \$-      |
| Common stock issued in satisfaction of accrued liabilities   | \$155,961 | \$4,100  |
| 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, 2009. 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, 2009 as reported in Form 10-K have been omitted.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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 losses from operations for the nine months ended September 30, 2010 of \$741,846. Because of these losses, the current working capital deficit, and the projection of additional losses for the remainder of 2010, the Company will require additional working capital to develop its business operations.

The Company intends to raise additional working capital through the use of private placements, public offerings, bank financing 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.



## 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, 2010 approximately \$43,000 of our receivables had been factored.

## NOTE 5 - CONVERTIBLE DEBT

The following table illustrates the carrying value of convertible debt:

|                       | September 30, 2010 |          |                | December 31, 2009 |            |                |
|-----------------------|--------------------|----------|----------------|-------------------|------------|----------------|
|                       | Principal          | Discount | Carrying Value | Principal         | Discount   | Carrying Value |
| \$2,825,000 financing | \$1,440,933        | \$-      | \$1,440,933    | \$1,564,949       | \$(8,277)  | \$1,556,672    |
| \$ 600,000 financing  | 600,000            | -        | 600,000        | 600,000           | (17,888)   | 582,112        |
| \$ 300,000 financing  | 300,000            | -        | 300,000        | 300,000           | (14,393)   | 285,607        |
|                       | \$2,340,933        | -        | \$2,340,933    | \$2,464,949       | \$(40,558) | \$2,424,391    |

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, 2010 |             |             |             |
|-----------------------------|---------------------------------------|-------------|-------------|-------------|
|                             | Inception                             | 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) |

|                             | Three Months ended September 30, 2009 |             |             |           |
|-----------------------------|---------------------------------------|-------------|-------------|-----------|
|                             | Inception                             | Adjustments | Redemptions | Total     |
| Derivative income (expense) |                                       |             |             |           |
| \$2,825,000 financing       | \$-                                   | \$142,564   | \$-         | \$142,564 |
| \$ 600,000 financing        | -                                     | 321,574     | -           | 321,574   |
| \$ 300,000 financing        | -                                     | 1,855       | -           | 1,855     |
| Preferred stock, Series B   | -                                     | 188,406     | -           | 188,406   |
|                             | \$-                                   | \$654,399   | \$-         | \$654,399 |

|                             | Nine Months ended September 30, 2010 |             |             |            |
|-----------------------------|--------------------------------------|-------------|-------------|------------|
|                             | Inception                            | Adjustments | Redemptions | Total      |
| Derivative income (expense) |                                      |             |             |            |
| \$2,825,000 financing       | \$-                                  | \$6,668     | \$(30,709)  | \$(24,041) |

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|                           |     |            |              |          |
|---------------------------|-----|------------|--------------|----------|
| \$ 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 |

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Nine Months ended September 30, 2009

| Derivative income (expense) | Fair Value |                 |             | Total         |
|-----------------------------|------------|-----------------|-------------|---------------|
|                             | Inception  | Adjustments     | Redemptions |               |
| \$2,825,000 financing       | \$-        | \$ (1,204,436 ) | \$ -        | \$(1,204,436) |
| \$ 600,000 financing        | -          | (248,136 )      | -           | (248,136 )    |
| \$ 300,000 financing        | -          | 19              | -           | 19            |
| Preferred stock, Series B   | -          | (170,310 )      | -           | (170,310 )    |
|                             | \$-        | \$ (1,622,863 ) | \$ -        | \$(1,622,863) |

The following table illustrates the components of derivative liabilities:

|                       | September 30, 2010  |                   |                | Total       |
|-----------------------|---------------------|-------------------|----------------|-------------|
|                       | Compound Derivative | Warrant Liability | Other warrants |             |
| \$2,825,000 financing | \$1,629,872         | \$8               | \$-            | \$1,629,880 |
| \$ 600,000 financing  | 591,596             | 6,049             | -              | 597,645     |
| \$ 300,000 financing  | -                   | 200               | -              | 200         |
|                       | \$2,221,468         | \$6,257           | \$-            | \$2,227,725 |

|                       | December 31, 2009   |                   |                | Total       |
|-----------------------|---------------------|-------------------|----------------|-------------|
|                       | Compound Derivative | Warrant Liability | Other warrants |             |
| \$2,825,000 financing | \$1,636,133         | \$657             | \$-            | \$1,636,790 |
| \$ 600,000 financing  | 605,639             | 5,079             | -              | 610,718     |
| \$ 300,000 financing  | -                   | 1,530             | -              | 1,530       |
|                       | \$2,241,772         | \$7,266           | \$-            | \$2,249,038 |

All of our financings with Yorkville have matured and are currently in default. As such, all amounts of unpaid principal and interest are due and payable.

The following table summarizes the number of common shares indexed to the derivative financial instruments as of September 30, 2010:

| Financing or other contractual arrangement: | Conversion  |           | Total       |
|---|-------------|-----------|-------------|
|   | Features    | Warrants  |             |
| \$2,825,000 Convertible note financing      | 407,468,034 | 8,333     | 407,476,367 |
| \$ 600,000 Convertible note financing       | 147,899,063 | 1,141,304 | 149,040,367 |
| \$ 300,000 Convertible note financing       | 67,490      | 33,333    | 100,823     |
|   | 555,434,587 | 1,182,970 | 556,617,557 |

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, 2010, Yorkville converted \$87,700 of principal into 5,977,303 shares of the Company's common stock. A gain of \$36,575 was recognized on the conversions.

All of the Company's convertible debt instruments are past due and in default. 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 calculation.

## NOTE 6 - OTHER STOCKHOLDERS' EQUITY

## a) Stock Options:

The following table summarizes stock option activity:

|                                   | Total<br>Options | Weighted<br>Average<br>Price |
|-----------------------------------|------------------|------------------------------|
| Outstanding, December 31, 2009    | 38,528           | \$2.97                       |
| Granted                           | -                |                              |
| Cancelled                         | -                |                              |
| Forfeited                         | (364 )           | \$3.00                       |
| Exercised                         | -                |                              |
| Outstanding, September 30, 2010   | 38,164           | \$2.97                       |
| Exercisable at September 30, 2010 | 34,441           |                              |

## b) Outstanding warrants:

At September 30, 2010, the Company had the following warrants outstanding:

|                       | Grant Date | Expiration Date | Warrants<br>Granted | Exercise Price |
|-----------------------|------------|-----------------|---------------------|----------------|
| \$2,825,000 financing | 07/21/06   | 07/21/11        | 8,333               | \$ 6.00        |
| \$ 300,000 financing  | 03/19/08   | 03/19/13        | 33,333              | \$ 6.00        |
|                       |            |                 | 41,666              |                |

## c) Reverse stock split:

All common share amounts and per share amounts in the accompanying financial statements for the three months ended September 30, 2009 reflect retroactive application of the one-for-three hundred reverse stock split of the issued and outstanding shares of common stock of the Company, effective April 8, 2009.

## d) Issuance of common stock:

The following table summarizes common stock issued for services during the nine month period ended September 30, 2010:

|                       | Shares    | Value     |
|-----------------------|-----------|-----------|
| Employee compensation | 6,894,000 | \$108,320 |
| Professional fees     | 692,318   | 23,717    |
|                       | 7,586,318 | \$132,037 |

The following table summarizes other common stock issued for during the nine month period ended September 30, 2010:

|  | Shares     | Value     |
|--|------------|-----------|
| Satisfaction of payables                           | 6,389,015  | \$155,961 |
| Redemption of convertible debenture                | 5,977,303  | 118,569   |
| Contribution for proposed joint venture investment | 2,500,000  | 20,000    |
| Notes payable                                      | 714,748    | 3,574     |
|  | 15,581,066 | \$298,104 |

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

e) Dividends on preferred stock:

At September 30, 2010 and December 31, 2009, there were cumulative undeclared dividends to Preferred Series B shareholders of \$29,937 and \$23,950, respectively, the obligation for which is contingent on declaration by the board of directors.



NOTE 7 – RELATED PARTY TRANSACTIONS

During the period ended September 30, 2010, the Company received advances of \$20,000 from directors of the Company and made repayments of \$35,053 on certain related party notes payable.

NOTE 8 – 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, |            |
|---------------------------|------------|
| 2010                      | \$ 18,675  |
| 2011                      | 46,065     |
| 2012                      | 49,053     |
| 2013                      | 52,041     |
| 2014                      | 55,029     |
| 2015                      | 33,117     |
|                           | \$ 253,980 |

NOTE 9 – SUBSEQUENT EVENTS

The Company issued the following shares subsequent to September 30, 2010:

|  |            |
|--|------------|
| Shares issued in connection with redemptions on our convertible debentures | 5,755,479  |
| Shares issued in satisfaction of notes payable                             | 19,022,261 |
|  | 24,777,740 |

## 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.

## RESULTS OF OPERATIONS

### THREE MONTHS ENDED SEPTEMBER 30, 2010 COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 2009:

During the three-month period ended September 30, 2010 (the "2010 Period") revenues were \$376,648 compared to revenues of \$386,903 during the three-month period ended September 30, 2009 (the "2009 Period"). Our revenues decreased modestly compared to the previous year as customers postponed purchases of videoconferencing services, infrastructure and room systems; and delayed spending on software development services for billing integration, custom engineering, and IT consulting projects.

Cost of revenues was \$243,621 for the 2010 Period compared to \$313,723 for the 2009 Period. Cost of revenues represents primarily labor and labor-related costs in addition to overhead costs. Gross profit on these 2010 revenues amounted to \$133,027 (35% gross profit percentage) compared to \$73,180 (19% gross profit percentage) for the 2009 Period. The reduced gross profit percentage resulted from our investment of operational resources into our CoroCall telepresence service that we believe will result in new business in the coming months.

Research and development was \$51,097 for the 2010 Period compared to \$0 in the 2009 Period. The increased research and development investment resulted from our software development and testing initiatives, including CoroWare Usage Reporter for Vidyo Systems, CoroWare Billing Integration Framework for MetraTech and Vidyo, and CoroWare NameTag.

Operating expenses were \$479,376 during the 2010 Period compared to \$313,116 during the 2009 Period. Selling expenses were higher in the 2010 Period as the Company increased its sales and marketing expenses to help increase major account sales of CoroCall and CoroWare's telepresence product sales in the coming months.

Loss from operations was \$346,349 during the 2010 Period compared to \$239,936 in the 2009 Period. The increase in this loss is a result of increasing our Research and Development and Sales activities in telepresence to increase sales in 2010.

Total other income (expense) was (\$1,061,716) during the 2010 Period compared to (\$371,742) in the 2009 Period. Other income (expense) is comprised primarily of derivative income (expense) and amortization of debt discount and deferred finance costs. Derivative expense in the 2010 Period was (\$923,670) compared to derivative income of \$654,399 in the 2009 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 and volatility increases and, likewise, decreases when our share price and share price volatility decreases. Derivative income (expense) displays the inverse relationship. The derivative expense in the 2010 Period is the result of a decreased share price (\$.012 at June 30, 2010 versus \$0.006 at September 30, 2010) but a significant increase in our share price volatility that was used in our September 30, 2010 volatility calculation (144% at June 30, 2010 versus 331% at September 30, 2010). The increase in the share price volatility that was used in our September 30, 2010 volatility calculation had a greater effect on the calculated value than the reduced share price. As such, the result was an increase in the calculated value, the increase of the liability associated with the embedded conversion feature and the recording of derivative expense. The derivative income in the 2009 Period was related to a decreased share price at the measurement dates (\$0.179 at June 30, 2009 versus \$0.12 at September 30, 2009) with volatility remaining constant at 193%. The derivative income in the 2009 Period was also the indirect result of losing the par floor on the conversion feature subsequent to the 1-for-300 reverse split. The par floor had the effect of limiting the number of shares indexed to the debt and thus limiting the liability. Subsequent to the reverse split, the stock was trading well above par so the number of shares indexed to the debt was not limited, the liability was thus greater and derivative expense was

recorded. Interest expense for the three month 2010 Period is \$142,061 compared to \$1,026,141 for the three month 2009 Period. The decrease in interest expense is a direct result of the amortization of debt discount on the convertible debt. 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. The debt discounts associated with the \$2.8 million financing and the \$600,000 financing finished amortizing in the fourth quarter of 2009.

Net loss for the 2010 Period was \$1,408,065 compared to net loss of \$611,678 for the 2009 Period.

Basic and diluted weighted average shares outstanding were 24,634,725 during the 2010 Period compared to 2,953,870 in the 2009 Period.

NINE MONTHS ENDED SEPTEMBER 30, 2010 COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 2009:

During the nine-month period ended September 30, 2010 (the "2010 Period") revenues were \$1,555,270 compared to revenues of \$1,461,009 during the nine-month period ended September 30, 2009 (the "2009 Period"). Our revenues increased in the 2010 period compared to the previous year as customers began to purchase videoconferencing services, infrastructure and room systems; and increasingly request CoroWare's software development services for billing integration, social networking, and game testing projects.

Cost of revenues was \$1,176,497 for the 2010 Period compared to \$982,800 for the 2009 Period. Cost of revenues represents primarily labor and labor-related costs in addition to overhead costs. Gross profit on these 2010 revenues amounted to \$378,773 (24% gross profit percentage) compared to \$478,209 (33% gross profit percentage) for the 2009 Period revenues.

Research and development was \$86,904 for the 2010 Period compared to \$87 in the 2009 Period. The increased research and development investment resulted from our software development and testing initiatives, including CoroWare Usage Reporter for Vidyo Systems, CoroWare Billing Integration Framework for MetraTech and Vidyo, and CoroWare NameTag.

Operating expenses were \$1,120,619 during the 2010 Period compared to \$882,003 during the 2009 Period. Selling expenses were higher in the 2010 Period as the Company increased its sales and marketing expenses to help increase major account sales of CoroCall and CoroWare's telepresence product sales in the coming months.

Loss from operations was \$741,846 during the 2010 Period compared to \$403,794 in the 2009 Period. The increase in this loss is a result of increasing our Research and Development and Sales investments in telepresence to increase sales in 2010.

Total other income (expense) was (\$416,112) during the 2010 Period compared to (\$3,638,932) in the 2009 Period. Other income (expense) is comprised primarily of derivative income (expense) and amortization of debt discount and deferred finance costs. Derivative income in the 2010 Period was \$76,772 compared to derivative expense of (\$1,622,863) in the 2009 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. The derivative income in the 2010 Period is the result of a decreased share price (\$.08 at December 31, 2009 versus \$0.006 at September 30, 2010) but an increase in our share price volatility that was used in our September 30, 2010 volatility calculation (193% at December 31, 2009 versus 331% at September 30, 2010). The reduction in the share price had a greater effect on the calculated value than the increased volatility factor that was used in our September 30, 2010 volatility calculation. As such, the result was a decrease in the calculated value, the reduction of the liability associated with the embedded conversion feature and the recording of derivative income. The derivative expense in the 2009 Period was related to an increased share price at the measurement dates (\$0.03 at December 31, 2008 versus \$0.12 at September 30, 2009) with volatility remaining constant at 193%. Interest expense for the nine month 2010 Period is \$559,615 compared to \$2,016,069 for the nine month 2009 Period. The decrease in interest expense is a direct result of the amortization of debt discount on the convertible debt. 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. The debt discounts associated with the \$2.8 million financing and the \$600,000 financing finished amortizing in the fourth quarter of 2009.

Net loss for the 2010 Period was \$1,157,958 compared to net loss of \$4,042,726 for the 2009 Period.

Basic and diluted weighted average shares outstanding were 15,356,860 during the 2010 Period compared to 2,931,369 in the 2009 Period. Total issued and outstanding shares increased by 23,167,384 (from 4,506,191 to 27,673,575 at December 31, 2009 and September 30, 2010, respectively) during the current nine month period as a result of redeeming stock in accordance with outstanding debentures, compensating key employees with common stock, and extinguishing outstanding debt obligations in exchange for common stock.

## LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2010, we had current assets of \$138,997, current liabilities of \$10,464,562, negative working capital of \$10,325,565 and an accumulated deficit of \$25,587,043.

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, 2009:

|                                | Total       | Payments due by Period |           |           |                   |
|--------------------------------|-------------|------------------------|-----------|-----------|-------------------|
|                                |             | Less than 1 year       | 1-3 years | 3-5 years | More than 5 years |
| Contractual Obligations        |             |                        |           |           |                   |
| Convertible debt, net          | \$2,468,525 | \$2,468,525            | \$-       | \$-       | \$-               |
| Notes payable                  | 357,732     | 357,732                | -         | -         | -                 |
| Notes payable, related parties | 408,229     | 408,229                | -         | -         | -                 |
| Operating leases               | 68,751      | 27,482                 | 41,269    | -         | -                 |
| Long-term debt                 | 989,100     | 989,100                | -         | -         | -                 |
| Total                          | \$4,292,337 | \$4,251,068            | \$41,269  | \$-       | \$-               |

## EFFECT OF RECENT ACCOUNTING PRONOUNCEMENTS

Refer to Form 10-K for the year ended December 31, 2009.

## 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, except that we were unable to timely file our 10K for the year ending December 31, 2009.

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) As of July 21, 2009, we are in default on our Secured Convertible Debenture presently held by Yorkville Advisors, LLC. The first tranche of this debenture was issued on July 21, 2006 in the original principal amount of \$1,250,000 and the second tranche was issued on August 21, 2006 in the original principal amount of \$575,000. 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 25, 2009, 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 March 19, 2010, 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.

ITEM 4. (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

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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 22, 2010

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)