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

FORM 10-Q

(Mark One)

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

For the quarterly period ended **June 30, 2013**

OR

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

For the transition period from __________________ to __________________

Commission File Number: 000-33155

COATES INTERNATIONAL, LTD.

(Exact name of registrant as specified in its charter)

Delaware	**22-2925432**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

(Address of principal executive offices) (Zip Code)

N/A

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

(732) 449-7717

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☒ No ☐

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

Large accelerated filer ☐ Accelerated filer Non-accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.)

Yes ☐ No ☒

As of August 9, 2013, 354,258,034 shares of the Registrant's common stock, par value $0.0001 per share were issued and outstanding.

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

CONTENTS

JUNE 30, 2013

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

Coates International, Ltd. and Subsidiaries
Consolidated Balance Sheets

	June 30, 2013 (Unaudited)	December 31, 2012
Assets		
Current Assets		
Cash	$ 7,679	$ 13,303
Inventory, net	111,115	111,115
Deferred offering costs	12,499	16,207
Total Current Assets	131,293	140,625
Property, plant and equipment, net	2,210,746	2,241,847
Deferred licensing costs, net	53,157	55,299
Total Assets	$ 2,395,196	$ 2,437,771
Liabilities and Stockholders' Deficiency		
Current Liabilities		
Accounts payable and accrued liabilities	$ 2,071,696	$ 1,797,439
Mortgage loan payable	1,540,000	1,575,000
Promissory notes to related parties	651,323	507,694
Deferred compensation payable	279,645	1,911,775
Convertible promissory notes, net of unamortized discount	41,750	77,363
Estimated fair value of embedded derivative liabilities related to convertible promissory notes	627,753	135,263
Unearned revenue	19,124	19,124
10% Convertible note	10,000	10,000
Total Current Liabilities	5,241,291	6,033,658
License deposits	331,800	341,400
Total Liabilities	5,573,091	6,375,058
Commitments and Contingencies		
Stockholders' Deficiency		
Preferred Stock, $0.001 par value, 100,000,000 shares authorized, 121,580 and 72,883 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively	122	73
Common Stock, $0.0001 par value, 1,000,000,000 shares authorized, 350,400,508 and 305,078,818 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively	35,040	30,508
Additional paid-in capital	29,996,083	27,259,253
Accumulated deficit	(33,209,140)	(31,227,121)
Total Stockholders' Deficiency	(3,177,895)	(3,937,287)
Total Liabilities and Stockholders' Deficiency	$ 2,395,196	$ 2,437,771

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

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2013	2012	2013	2012
Sublicensing fee revenue	$ 4,800	$ 4,800	$ 9,600	$ 9,600
Expenses:				
Research and development costs	79,364	135,792	79,364	321,858
General and administrative expenses	570,335	1,209,702	1,193,947	2,264,478
Depreciation and amortization	16,621	11,513	33,242	26,581
Total Expenses	666,320	1,357,007	1,306,553	2,612,917
Loss from Operations	(661,520)	(1,352,207)	(1,296,953)	(2,603,317)
Other Income (Expense):				
(Increase) decrease in estimated fair value of embedded derivative liabilities	(412,515)	(37,400)	(482,929)	(8,808)
Interest expense	(102,136)	(98,950)	(202,137)	(275,717)
Total other income (expense)	(514,651)	(136,350)	(685,066)	(284,525)
Loss Before Income Taxes	(1,176,171)	(1,488,557)	(1,982,019)	(2,887,842)
Provision for income taxes	-	-	-	-
Net Loss	$ (1,176,171)	$ (1,488,557)	$ (1,982,019)	$ (2,887,842)
Basic net loss per share	$ -	$ -	$ (0.01)	$ (0.01)
Basic weighted average shares outstanding	343,131,130	298,535,876	335,863,959	292,489,203
Diluted net loss per share	$ -	$ -	$ (0.01)	$ (0.01)
Diluted weighted average shares outstanding	343,131,130	298,535,876	335,863,959	292,489,203

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

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

	For the Six Month Ended June 30, 2013	2012
Net Cash (Used in) Operating Activities	$ (373,810)	$ (641,935)
Net Cash Provided by (Used in) Investing Activities	-	-
Cash Flows Provided by (Used in) Financing Activities:		
Issuance of promissory notes to related parties	166,629	489,519
Repayment of promissory notes to related party	(23,000)	-
Issuance of convertible promissory notes	160,000	137,000
Issuance of common stock and warrants	95,000	138,888
Issuance of common stock under equity line of credit	4,557	(40,500)
Repayment of Mortgage Loan	(35,000)	(25,000)
Net Cash Provided by Financing Activities	368,186	699,907
Net Increase (Decrease) in Cash	(5,624)	57,972
Cash, beginning of period	13,303	52,955
Cash, end of period	$ 7,679	$ 110,927
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for interest	$ 69,313	$ 51,308
Supplemental Disclosure of Non-cash Financing Activities:		
Deferred compensation payable paid with common stock	$ 1,761,175	$ 108,160
Conversion of convertible promissory notes	126,000	243,880
	$ 1,887,175	$ 352,040

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

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

1. BASIS OF PRESENTATION

Basis of Presentation

The accompanying unaudited financial statements of Coates International, Ltd. (the "Company", or "CIL") have been prepared in accordance with accounting principles generally accepted for interim financial information and rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, they do not include all of the information and notes required by generally accepted accounting principles in the United States ("GAAP") for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for the three and six months ended June 30, 2013 and 2012 are not necessarily indicative of the results that may be expected for any other interim period or for the full year. The unaudited financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2012 and the unaudited financial statements and notes thereto included in the Company's quarterly report on Form 10-Q for the three months ended March 31, 2013.

Going Concern

As shown in the accompanying financial statements, the Company has incurred recurring losses from operations ($33,209,000), primarily consisting of research and development expenses and, as of June 30, 2013, had a stockholders' deficiency of ($3,178,000). In addition, the current economic environment, which is characterized by tight credit markets, investor uncertainty about how to safely invest their funds and low investor confidence, has introduced additional risk and difficulty to the Company's challenge to secure needed additional working capital. These factors raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments that might be necessary should the Company become unable to continue as a going concern.

Management has instituted a cost control program intended to restrict variable costs to only those expenses that are necessary to carry out the Company's activities related to entering the production phase of operations, develop additional commercially feasible applications of the CSRV system technology, seek additional sources of working capital and cover general and administrative costs in support of such activities. The Company continues to actively undertake efforts to secure new sources of working capital. At the June 30, 2013, the Company had negative working capital of ($5,110,000) compared with negative working capital of ($5,893,000) at December 31, 2012.

2. ACCOUNTING POLICIES

Principles of Consolidation

CIL is currently the majority shareholder in Coates Hi-Tech Engines, Ltd. ("Coates Hi-Tech"), a Delaware corporation which was formed in July 2012. It has not commenced operations and has no assets. Accordingly, this subsidiary has not been consolidated with the accounts of CIL. CIL plans to spin off its manufacturing operations and grant a license to the rights to its intellectual property to Coates Hi-Tech. The shareholders of CIL would receive shares of Coates Hi-Tech based on the percentage of common stock owned on the record date to be established for this tax-free spin-off transaction.

Coates Hi-Tech would then become responsible for the manufacturing operations to produce Coates Spherical Rotary Valve ("CSRV") products. In that event, CIL would then be primarily focused on research and development activities. The spin-off transaction is discussed in more detail in Note 7.

Since July 2011, the financial statements of CIL were consolidated with the accounts of Coates Oklahoma Engine Manufacturing, Ltd. ("Coates Oklahoma"). In May 2013, Coates Oklahoma was shuttered and is now in the process of being dissolved. There are no outstanding obligations or expenses in dissolving this company. It is no longer being consolidated with the financial statements of the Company.

Loss per Share

Basic net loss per share is based on the weighted average number of common shares outstanding without consideration of potentially dilutive shares of common stock. There were no shares of preferred stock outstanding with rights to share in the Company's net income during the six month periods ended June 30, 2013 and 2012. Diluted net income per share is based on the weighted average number of common and potentially dilutive common shares outstanding, when applicable.

Use of Estimates

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

3. CONCENTRATIONS OF CREDIT AND BUSINESS RISK

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

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

4. LICENSING AGREEMENT AND DEFERRED LICENSING COSTS

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

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

At June 30, 2013, deferred licensing costs, comprised of expenditures for patent costs incurred pursuant to the CSRV licensing agreement, net of accumulated amortization, amounted to $53,000. Amortization expense for the three months ended June 30, 2013 and 2012 amounted to $1,000 and $1,000, respectively. Amortization expense for the six months ended June 30, 2013 and 2012 amounted to $2,000 and $2,000, respectively.

5. AGREEMENTS ASSIGNED TO ALMONT ENERGY INC.

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

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

The Escrow Agreement requires that Almont, as the assignee, make a payment ("Release Payment") to the Company equal to the then remaining unpaid balance of the Canadian License licensing fee, the R&D Agreement fee and the down payment of $1,000,000 required under the US License. It is not likely that Almont will be able to make additional payments of the Release Payment until the Company can raise sufficient new working capital to commence production and shipment of Gen Sets to Almont. At June 30, 2013, the remaining balance of the Release Payment due to the Company was $5,847,000.

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

- The Release Payment Date, as defined in the Escrow Agreement had been extended to March 2014 to compensate for the delay caused by the late delivery of Gen Sets. Provided that Almont remits this entire unpaid balance to the Company on or before the Release Payment Date, the US License will be released from escrow and granted to Almont. Almont is required to remit to the Company 60% of all monies it raises from future equity or debt transactions, exclusive of proceeds from equipment purchase financing transactions, until the Release Payment is paid in full.

- Almont also became obligated to pay the $49 million balance of the US License Fee to the Company. Payment shall be made quarterly in an amount equal to 5% of Almont's quarterly net profits. In addition, Almont is required to remit a portion of the proceeds it receives from equity or debt transactions, exclusive of equipment financing transactions to the Company until the entire balance of the US License fee is paid in full. However, the entire $49 million licensing fee is required to be paid on or before February 19, 2016.

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

The Canadian License

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

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

The US License

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

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

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

6. COOPERATION AGREEMENT WITH TONGJI UNIVERSITY OF CHINA

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

7. PLAN TO SPIN OFF OPERATIONS

In July 2013, the Company announced its intention to spin off its manufacturing operations and grant a license to the rights to its intellectual property covering the CSRV System technology to Coates Hi-Tech, a majority owned subsidiary. Consummation of this spin-off transaction is dependent on the success in raising the new working capital. As consideration for the manufacturing operations and licensed rights, Coates Hi-Tech would be obligated to pay the Company $10,000,000 as follows: $1,000,000 from the new working capital to be raised by Coates Hi-Tech (as explained in more detail below) from the sale of up to $20 million of Coates Hi-Tech's common stock and the balance in periodic installments from positive cash flow of Coates Hi-Tech in amounts that will not materially impact on the Coates Hi-Tech's cash flow as determined by Coates Hi-Tech's board of directors, in its sole discretion. The first $1 million portion of the fee to CIL will be paid as follows: 5% of the amount raised up to the first $10 million; and, 50% of the amount raised above $10 million until the $500,000 balance of the first $1 million fee shall have been paid in full.

In the event this spin-off transaction is consummated, the Company would establish a record date for the spin-off transaction. All shareholders of the Company as of the record date would receive shares of Coates Hi-Tech's common stock. Shareholders of record would be issued that number of shares of Coates Hi-Tech's common stock that would result in substantially the same percentage ownership of Coates Hi-Tech as the percentage of CIL's common stock outstanding that such CIL shareholders owned on the record date. The actual resulting percentage ownership in Coates Hi-Tech would be diluted by a relatively small number of shares of common stock of Coates Hi-Tech previously issued to certain founding stockholders. After issuance of the shares to CIL stockholders, the founding stockholders would own approximately 0.27% of the outstanding shares of Coates Hi-Tech's common stock.

8. LICENSE DEPOSITS

License deposits, which are non-refundable, primarily relate to a $300,000 sublicense deposit received in prior years as a down payment on the Canadian License. This sublicense deposit is being recognized as revenue on a straight-line basis over the remaining life until 2027 of the last CSRV technology patent in force, at that date. Sublicensing fee revenue for the three months ended June 30, 2013 and 2012 amounted to $5,000 and $5,000, respectively. Sublicensing fee revenue for the six months ended June 30, 2013 and 2012 amounted to $10,000 and $10,000, respectively.

9. INVENTORY

Inventory was comprised of the following:

	June 30, 2013	December 31, 2012
Raw materials	$ 439,000	$ 439,000
Work-in-process	59,000	59,000
Finished goods	-	-
Reserve for obsolescence	(387,000)	(387,000)
Total	$ 111,000	$ 111,000

10. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment were comprised of the following:

	June 30, 2013	December 31, 2012
Land	$ 1,235,000	$ 1,235,000
Building	964,000	964,000
Building improvements	83,000	83,000
Machinery and equipment	658,000	658,000
Furniture and fixtures	39,000	39,000
	2,979,000	2,979,000
Less: Accumulated depreciation	(768,000)	(737,000)
Total	$ 2,211,000	$ 2,242,000

Depreciation expense for the three months ended June 30, 2013 and 2012 was $16,000 and $10,000, respectively. Depreciation expense for the six months ended June 30, 2013 and 2012 was $31,000 and $24,000, respectively.

11. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consisted of the following:

	June 30, 2013	December 31, 2012
Legal and professional fees	$ 1,327,000	$ 1,240,000
Accrued compensation and benefits	189,000	175,000
General and administrative expenses	271,000	149,000
Accrued interest payable	170,000	118,000
Research and development	115,000	115,000
Total	$ 2,072,000	$ 1,797,000

12. MORTGAGE LOAN PAYABLE

The Company has a mortgage loan on the land and building that serves as its headquarters and research and development facility which bears interest at the rate of 7.5% per annum. The loan requires monthly payments of interest, plus $5,000 which is being applied to the principal balance. The remaining principal balance at June 30, 2013 was $1,540,000.The mortgage lender has informed the Company that it has approved a one-year extension of the mortgage loan to July 2014 on the same terms and conditions.

Interest expense for the three months ended June 30, 2013 and 2012 on this mortgage amounted to $30,000 and $31,000, respectively. Interest expense for the six months ended June 30, 2013 and 2012 on this mortgage amounted to $59,000 and $61,000, respectively.

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

13. PROMISSORY NOTES TO RELATED PARTIES

During the six months ended June 30, 2013 and 2012, the Company issued, in a series of transactions, promissory notes to George J. Coates and received cash proceeds of $99,000 and $73,000, respectively, and repaid promissory notes in the aggregate principal amount of $17,000 and $31,000, respectively, bringing the outstanding principal balance at June 30, 2013 to $524,000. The promissory notes are payable on demand and provide for interest at the rate of 17% per annum, compounded monthly.

During the six months ended June 30, 2013 and 2012, the Company issued, in a series of transactions, promissory notes to Bernadette Coates, spouse of George J. Coates and received cash proceeds of $67,000 and $66,000, respectively, and repaid promissory notes in the aggregate principal amount of $7,000 and $10,000, respectively, bringing the outstanding balance at June 30, 2013 to $127,000. The promissory notes are payable on demand and provide for interest at the rate of 17% per annum, compounded monthly.

During the six months ended June 30, 2012, the Company had outstanding promissory notes with two of its directors, Dr. Richard W. Evans and Dr. Frank J. Adipietro with principal balances of $120,000 and $50,000, respectively. In June 2012, by mutual agreement, the $120,000 principal amount promissory note issued to Dr. Evans and $10,000 principal amount of the promissory note issued to Dr. Adipietro was converted into 2,000,000 and 166,667 shares of common stock, respectively, at a conversion price of $0.06 per share. The $40,000 principal balance, plus accrued interest on the promissory note due to Dr. Adipietro was converted in to 473,372 shares of common stock in October 2012. These notes were due on demand and provided for interest at the rate of 17% per annum, compounded monthly.

For the three months ended June 30, 2013 and 2012, aggregate interest expense on all of these promissory notes amounted to $32,000 and $12,000, respectively. For the six months ended June 30, 2013 and 2012, aggregate interest expense on all of these promissory notes amounted to $62,000 and $33,000, respectively. Unpaid accrued interest on these promissory notes amounting to $158,000 is included in accounts payable and accrued liabilities in the accompanying balance sheet at June 30, 2013.

14. CONVERTIBLE PROMISSORY NOTES AND EMBEDDED DERIVATIVE LIABILITIES

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

8% Convertible Promissory Note

At June 30, 2013, there are two 8% convertible promissory notes (8% Notes") in the principal amounts of $43,000 and $32,000 which mature in February 2014 and March 2014, respectively, if not converted prior thereto. The 8% Notes may be converted into unregistered shares of the Company's common stock, par value $0.0001 per share (the "Common Stock"), at the Conversion Price, as defined below, in whole, or in part, at any time beginning 180 days after the date of issuance of the Notes, at the option of the holder. The Conversion Price shall be equal to 61% multiplied by the Variable Conversion Rate which is equal to the average of the three (3) lowest closing bid prices of the Common Stock during the ten (10) trading day period prior to the date of conversion. The 8% Notes also contain a prepayment option whereby the Company may, during the first 179 days the note is outstanding, prepay the 8% Note by paying 130% during the first 60 days, increasing in 5% increments each month to a maximum of 150% of the then outstanding unpaid principal, interest and any other amounts that might be due for penalties or any event of a default.

The 61% discounted Conversion Price establishes a beneficial conversion feature ("BCF") or unamortized discount which is required to be valued and accreted to interest expense over the six-month period until the conversion of the 8% Notes into common stock is permitted. The Company has reserved 46,750,000 shares of its unissued common stock for potential conversion of these 8% Notes.

12% Convertible Promissory Note

The Company has also entered into an agreement whereby it is permitted to issue in a series of tranches up to $335,000 of convertible promissory notes which bear interest at 12% per annum and mature on the one-year anniversary of the agreement ("12% Notes"). In March 2013, the Company issued a $67,000, 12% Note under this arrangement and received cash proceeds of $60,000. In June 2013, the Company issued a $28,000, 12% Note under this arrangement and received cash proceeds of $25,000. These notes mature in March 2014 and June 2014, respectively, if not converted prior thereto. The arrangement provides for an approximately 10.5% original issue discount on the principal amount of each tranche, which is netted against the amount funded to the Company. Each drawdown of the promissory note may be prepaid at any time within the first 90 days after funding, upon which the interest for the outstanding period will be forgiven. The lender may convert the 12% Notes into shares of the Company's common stock at any time beginning 180 days after the date of funding. The conversion rate shall be equal to the lesser of $0.035 per share or 60% of the lowest trade price of the Company's common stock in the 25 trading days prior to the date of conversion. The Company has reserved 35 million shares of its unissued common stock for potential conversion of this 12% Note agreement.

In accordance with GAAP, the estimated fair value of the embedded derivative liability related to the 8% Notes and 12% Notes is required to be remeasured at each balance sheet date. The estimated fair value of the embedded derivative liabilities related to promissory notes outstanding was measured as the aggregate estimated fair value, based on Level 2 inputs.

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

The following table presents the details of the outstanding 8% Notes and 12% Notes at June 30, 2013 and December 31, 2012, including the balance of the unamortized discount and the amount of the embedded derivative liability:

Date Issued	Principal Amount June 30, 2013	Principal Amount December 31, 2012	Nominal Interest Rate	Effective Interest Rate(1)	Unamortized Discount June 30, 2013	Unamortized Discount December 31, 2012	Embedded Derivative Liability June 30, 2013	Embedded Derivative Liability December 31, 2012
6/21/13	$ 32,000	N/A	8%	147%	$ 31,000	N/A	$ 101,000	N/A
6/4/13	28,000	N/A	12%	92%	17,000	N/A	116,000	N/A
4/19/13	43,000	N/A	8%	150%	28,000	N/A	133,000	N/A
3/21/13	67,000	N/A	12%	76%	52,000	N/A	278,000	N/A
11/23/12	N/A	33,000	8%	101%	N/A	17,000	N/A	41,000
9/24/12	N/A	32,000	8%	122%	N/A	14,000	N/A	41,000
8/6/12	N/A	43,000	8%	142%	N/A	12,000	N/A	53,000
6/12/12	N/A	12,000	8%	142%	N/A	-	N/A	-
	$ 170,000	$ 120,000			$ 128,000	$ 43,000	$ 628,000	$ 135,000

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

Other expense resulting from the change in the estimated fair value of the embedded derivative liabilities amounted to ($413,000) and ($38,000) for the three months ended June 30, 2013 and 2012, respectively, and ($483,000) and ($9,000) for the six months ended June 30, 2013 and 2012, respectively. These amounts are included in the accompanying statements of operations as Decrease (Increase) in estimated fair value of embedded derivative liabilities. Interest expense resulting from accretion of the unamortized discount for the three months ended June 30, 2013 and 2012 amounted to $37,000 and $49,000, respectively. Interest expense resulting from accretion of the unamortized discount for the six months ended June 30, 2013 and 2012 amounted to $75,000 and $166,000, respectively.

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

15. 10% CONVERTIBLE NOTE TO RELATED PARTY

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

16. UNEARNED REVENUE

The Company has received a non-refundable deposit of $19,000 from Almont in connection with its order for a natural gas fueled electric power CSRV engine generator, which is included in unearned revenue in the accompanying balance sheet at June 30, 2013 and December 31, 2012.

17. CONTRACTUAL OBLIGATIONS

The following table summarizes the Company's contractual obligations at June 30, 2013:

		Due Within	
	Total	2013	2014
Mortgage loan payable	$ 1,540,000	$ 1,540,000	$ -
Promissory notes to related parties	651,000	651,000	-
Deferred compensation	280,000	280,000	-
Convertible promissory notes	170,000	75,000	95,000
10% promissory note	10,000	10,000	-
Total	$ 2,651,000	$ 2,556,000	$ 95,000

18. CAPITAL STOCK

Common Stock and Anti-dilution Rights

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

The following transactions occurred during the six months ended June 30, 2013:

In a series of transactions during 2013, the Company made private sales, pursuant to stock purchase agreements of 3,833,333 unregistered shares of its common stock and 4,833,335 common stock warrants to purchase one share of our common stock at an exercise prices ranging from $0.015 to of $0.035 per share in consideration for $95,000 received from the son of Richard W. Evans, a director.

In a series of transactions during 2013, the Company issued 50,000 registered shares of its common stock to Dutchess under the equity line of credit in consideration for $5,000.

In a series of transactions in 2013, the Company issued 12,213,322 unregistered shares of its common stock to George J. Coates for anti-dilution protection related to new shares of common stock issued in 2013. The estimated value of these shares, based on the closing trading price of the stock on the dates of the issuances was $322,000.

In connection with an agreement to issue up to $335,000 of convertible promissory notes, during 2013, the Company issued a $67,000 principal amount, 12% convertible promissory note and a $28,000 principal amount 12%, convertible promissory note and received cash proceeds of $85,000, net of original issue discount of $10,000. The lender may convert the promissory notes into unregistered shares of the Company's common stock at any time beginning 180 days after the date of funding. The conversion rate shall be equal to the lesser of $0.035 per share or 60% of the lowest trading price of the common stock in the 25 trading days prior to the date of conversion. The Company has reserved 35 million shares of its unissued common stock for potential conversion under the $335,000 convertible note agreement.

The Company issued a $43,000 principal amount, 8% convertible promissory note and a $32,000 principal amount, 8% convertible promissory note and received proceeds of $70,000, net of transaction costs.

In a series of transactions during 2013, 8% convertible promissory notes with an aggregate principal balance of $120,000, plus accrued interest of $6,000 were converted into 8,329,989 unregistered shares of common stock.

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

At June 30, 2013, Company had reserved 112,691,391 shares of its common stock to cover the potential conversion of convertible securities and exercise of stock options and warrants.

Preferred Stock and Anti-dilution Rights

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

The Board has designated 1,000,000 shares of Preferred Stock as Series A Preferred Stock, $0.001 par value per share. Each share of Series A Preferred Stock entitles the holder of record to the right to vote 10,000 shares of common stock with respect to all matters that are submitted to a vote of shareholders. The Series A Preferred Stock does not provide the holder any rights to share in dividends or any distribution of assets to any other shareholders of any other class of the Company's securities in a liquidation or for any other purpose.

Effective May 17, 2013, new anti-dilution provisions for the Coates family were put into place. Under these provisions, new shares of Series A Preferred Stock are to be issued to George J. Coates upon issuance of new shares of the Company's common stock to any person or entity that is not a Coates family member. The anti-dilution provisions do not apply to any secondary public offerings of the Company's common stock. The anti-dilution is calculated as the number of shares needed to ensure that the Coates family percentage of total eligible votes at all matters brought before the shareholders for a vote remains fixed at 93.93%.

During the six months ended June 30, 2013 and 2012, 48,697 and no shares of Series A Preferred Stock, respectively, were issued to George J. Coates under the anti-dilution provisions.

At June 30, 2013, George J. Coates held 121,580 shares of Series A Preferred Stock which provides him with the right to 1,215,800,000 aggregate additional votes on all matters brought before the shareholders for a vote.

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

19. INVESTMENT AGREEMENTS WITH DUTCHESS OPPORTUNITY FUND II, LP

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

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

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

During the six months ended June 30, 2013 and 2012, the Company sold 50,000 and 2,256,677 registered shares of its common stock, respectively, under this equity line of credit with Dutchess and received proceeds of $5,000 and $255,000, respectively, which were used for general working capital purposes. There were no offering costs related to the sales of these shares.

20. LOSS PER SHARE

For the six months ended June 30, 2013 and 2012, diluted net loss per share was based on the weighted average number of common shares outstanding without consideration of potentially dilutive shares of common stock because the Company incurred a net loss in those periods and the effect of including any of the potentially dilutive shares of common stock in the calculation would have been anti-dilutive.

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

		Number of Underlying Shares of Common Stock at June 30,	
Description	Exercise Price	2013	2012
Common stock options	$ 0.0600	5,607,000	5,607,000
Common stock options	0.2400	1,800,000	1,800,000
Common stock options	0.2500	2,000,000	2,000,000
Common stock options	0.3900	50,000	50,000
Common stock options	0.4000	360,000	360,000
Common stock options	0.4300	100,000	100,000
Common stock options	0.4400	1,750,000	1,750,000
Common stock options	1.0000	30,000	30,000
Common stock warrants	0.0150	666,667	
Common stock warrants	0.0200	500,000	
Common stock warrants	0.0225	666,667	
Common stock warrants	0.0250	1,000,000	
Common stock warrants	0.0350	2,000,001	-
Common stock warrants	0.0450	333,333	-
Common stock warrants	0.0500	400,000	-
Common stock warrants	0.0550	2,181,819	-
Common stock warrants	0.0600	2,000,000	-
Common stock warrants	0.0625	4,269,838	4,269,838
Common stock warrants	0.0700	571,429	544,583
Common stock warrants	0.0900	666,666	666,666
Common stock warrants	0.1200	416,667	416,667
Common stock warrants	0.2500	1,200,000	1,200,000
Common stock warrants	0.2700	833,333	833,333
Common stock warrants	0.3000	333,333	333,333
Common stock warrants	0.3250	153,846	153,846
Common stock warrants	0.3500	1,028,570	1,028,570
Common stock warrants	1.1000	-	210,000
$10,000, 10% Convertible promissory note	0.4500	22,222	22,222
8% Convertible promissory notes	(1)	8,955,458	3,931,870
12% Convertible promissory notes	(2)	14,924,005	-
Total		54,820,854	25,097,928

(1) The principal amount of the 8% convertible promissory notes outstanding, which were not eligible for conversion at June 30, 2013, was $75,000. The conversion rate is variable as it is equal to the average of the three lowest closing bid prices during the ten trading days prior to the date of conversion. The actual number of shares underlying these convertible instruments will likely vary from the number assumed above. The number of shares underlying these convertible notes was determined based on the three lowest closing bid prices during the ten trading days prior to June 28, 2013, the last trading day of the quarter.
(2) The principal amount of the 12% convertible promissory note outstanding, which was not eligible for conversion at June 30, 2013, was $95,000. The conversion rate is variable as it is equal to the lowest trading price during the twenty-five trading days prior to the date of conversion. The actual number of shares underlying these convertible instruments will likely vary from the number assumed above. The number of shares underlying these convertible notes was determined based on the lowest trading price during the twenty-five trading days prior to June 28, 2013, the last trading day of the quarter.

21. STOCK OPTIONS

The Company's 2006 Stock Option and Incentive Plan (the "Stock Plan") was adopted by the Company's board in October 2006. In September 2007, the Stock Plan, by consent of George J. Coates, majority shareholder, was adopted by our shareholders. The Stock Plan provides for the grant of stock-based awards to employees, officers and directors of, and consultants or advisors to, the Company and its subsidiaries, if any. Under the Stock Plan, the Company may grant options that are intended to qualify as incentive stock options ("incentive stock options") within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), options not intended to qualify as incentive stock options ("non-statutory options"), restricted stock and other stock-based awards. Incentive stock options may be granted only to employees of the Company. A total of 12,500,000 shares of common stock may be issued upon the exercise of options or other awards granted under the Stock Plan. The maximum number of shares with respect to which awards may be granted during any one year to any employee under the Stock Plan shall not exceed 25% of the 12,500,000 shares of common stock covered by the Stock Plan.

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

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

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

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

During the six months ended June 30, 2013 no employee stock options were granted. During the six months ended June 30, 2012, employee stock options to purchased 5,607,000 shares of common stock at a price per share of $0.06 per share were granted. These options fully vested in June 2013.

During the six months ended June 30, 2013, employee stock options to purchased 5,607,000 shares of common stock at a price per share of $0.06 per share became vested. During the six months ended June 30, 2012, 200,000 stock options with an exercise price of $0.25 per share became vested. There were no unvested stock options at June 30, 2013.

During the three months ended June 30, 2013 and 2012, the Company recorded non-cash stock-based compensation expense related to employee stock options amounting to $90,000 and $221,000, respectively. For the three months ended June 30, 2013 and 2012, $15,000 and $88,000, respectively, of this amount is included in research and development expenses and $75,000 and $133,000, respectively, of this amount is included in general and administrative expenses in the accompanying statements of operations.

During the six months ended June 30, 2013 and 2012, the Company recorded non-cash stock-based compensation expense related to employee stock options amounting to $179,000 and $461,000, respectively. For the six months ended June 30, 2013 and 2012, $15,000 and $176,000, respectively, of this amount is included in research and development expenses and $164,000 and $285,000, respectively, of this amount is included in general and administrative expenses in the accompanying statements of operations.

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

	Exercise Price Per Share	Number Outstanding	Weighted Average Remaining Contractual Life	Number Exercisable	Weighted Average Exercise Price	Weighted Average Fair Value Per Stock Option at Date of Grant
Balance, 1/1/13	$ 0.06 -1.00	11,697,000	14	6,090,000	$ 0.019	$ 0.180
Vested	$ 0.06		14	5,607,000	$ 0.060	$ 0.064
Balance, 6/30/13	$ 0.06 -1.00	11,697,000	14	11,697,000	$ 0.019	$ 0.180

No stock options were exercised, forfeited or expired during the six months ended June 30, 2013 and 2012.

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

- Historical stock price volatility 139-167%
- Risk-free interest rate 0.21%-4.64%
- Expected life (in years) 4
- Dividend yield 0.00%

The valuation assumptions were determined as follows:

- Historical stock price volatility: The Company initially obtained the volatility factor of other publicly traded engine manufacturers that were also in the research and development stage. Subsequently, once sufficient trading history became available, the volatility factor was calculated based on the historical daily closing prices of the Company’s common stock on the OTCBB.

- Risk-free interest rate: The Company bases the risk-free interest rate on the interest rate payable on U.S. Treasury securities in effect at the time of the grant for a period that is commensurate with the assumed expected option life.

- Expected life: The expected life of the options represents the period of time options are expected to be outstanding. The Company has very limited historical data on which to base this estimate. Accordingly, the Company estimated the expected life based on its assumption that the executives will be subject to frequent black-out periods during the time that the stock options will be exercisable and based on the Company’s expectation that it will complete its research and development phase and commence its initial production phase. The vesting period of these options was also considered in the determination of the expected life of each stock option grant.

- No expected dividends.

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

22. INCOME TAXES

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

Deferred tax assets increased by $244,000 and $425,000 for the three months ended June 30, 2013 and 2012, respectively. Deferred tax assets increased by $499,000 and $1,042,000 for the six months ended June 30, 2013 and 2012, respectively. These amounts were fully offset by a corresponding decrease in the tax valuation allowance resulting in no net change in deferred tax assets, respectively, during these periods.

No liability for unrecognized tax benefits was required to be reported at June 30, 2013 and 2012. Based on the Company's evaluation, it has concluded that there are no significant uncertain tax positions requiring recognition in the Company's financial statements. The Company's evaluation was performed for tax years ended 2009 through 2012, the only periods subject to examination. The Company believes that its income tax positions and deductions will be sustained on audit and does not anticipate that adjustments, if any, will result in a material change to its financial position. For the six months ended June 30, 2013 and 2012, there were no penalties or interest related to the Company's income tax returns.

23. RELATED PARTY TRANSACTIONS

Compensation and Benefits Paid

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

	For the Six Months Ended June 30,	
	2013	2012 (a)
George J. Coates (b), (c), (d), (e), (f)	$ 29,000	$ 140,000
Gregory Coates (g)	87,000	86,000
Bernadette Coates (h)	13,000	38,000

(a) Certain amounts for the six months ended June 30, 2012 were reclassified in order to make them comparable to the amounts for the three months ended June 30, 2013.
(b) For the six months ended June 30, 2013, George J. Coates earned additional base compensation of $106,000, payment of which is being deferred until the Company has sufficient working capital. This amount is included in deferred compensation in the accompanying balance sheet at June 30, 2013.
(c) During the six months ended June 30, 2013, George J. Coates was awarded 12,213,322 unregistered shares of the Company's common stock for anti-dilution protection related to new shares of common stock issued in 2013. The estimated value of these shares, based on the closing trading price of the stock on the dates of issuance was $322,000.
(d) George J. Coates was awarded 48,697 unregistered shares of the Company's Series A Preferred Stock for anti-dilution protection related to new shares of common stock issued in 2013. The estimated value of these shares was $112,000.
(e) During the six months ended June 30, 2013 and 2012, the Company recorded stock-based compensation expense in connection with employee stock options granted to George J. Coates during 2011 and 2012, amounting to $58,000 and $225,000, respectively.
(f) In January 2013, the Company issued 20,895,046 unregistered shares of its common stock to George J. Coates in satisfaction of a deferred compensation liability consisting of 20,275,046 shares for anti-dilution protection for the year ended December 31, 2012 and a 620,000 share stock award originally granted in 2011. The value of these shares, based on the closing trading price on the dates of the anti-dilution or the date of the stock award was $1,761,000, of which $1,674,000 and $87,000 was charged to stock compensation expense during the years ended December 31, 2012 and 2011, respectively.
(g) During the six months ended June 30, 2012, the Company recorded stock-based compensation expense in connection with employee stock options granted to Gregory Coates during 2011 amounting to $216,000.
(h) For the six months ended June 30, 2013, Bernadette Coates earned additional base compensation of $23,000, payment of which is being deferred until the Company has sufficient working capital. This amount is included in deferred compensation in the accompanying balance sheet at June 30, 2013.

Promissory Notes to Related Parties

Issuances of promissory notes to related parties during the six months ended June 30, 2013 and 2012 are discussed in detail in Note 13. The promissory notes to related parties are payable on demand and bear interest at the rate of 17% per annum, compounded monthly.

Issuances of Common Stock and Warrants

Issuances of common stock and common stock warrants to related parties during the six months ended June 30, 2013 are discussed in detail in Note 18. During the six months ended June 30, 2012, the Company sold 190,185 restricted shares of its common stock in consideration for 185,185 tradable shares of its common stock received from the son of Dr. Richard W. Evans, director.

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

Personal Guaranty and Stock Pledge

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

Other

During the three months ended June 30, 2013 and 2012, Barry C. Kaye, Treasurer and Chief Financial Officer was paid compensation of $5,000 and $12,000, respectively. For the three months ended June 30, 2013, Mr. Kaye earned compensation of $32,000, which was not paid and is being deferred until the Company has sufficient working capital to remit payment to him.

During the six months ended June 30, 2013 and 2012, Barry C. Kaye, Treasurer and Chief Financial Officer was paid compensation of $5,000 and $35,000, respectively. For the six months ended June 30, 2013, Mr. Kaye earned compensation of $61,000, which was not paid and is being deferred until the Company has sufficient working capital to remit payment to him.

At June 30, 2013, the total unpaid deferred compensation owed to Mr. Kaye amounted to $98,000. This amount is included in accounts payable and accrued liabilities in the accompanying balance sheet at June 30, 2013.

25. LITIGATION AND CONTINGENCIES

Mark D. Goldsmith, a former executive of the Company, filed a lawsuit against the Company in January 2008 in which he asserted that the Company was liable to him for breach of an employment contract. On August 14, 2013, the parties agreed on the terms of a tentative settlement. A final settlement agreement has not yet been executed. According to the main provisions of the settlement, the Company agreed to pay the plaintiff $125,000 in five installments of $40,000, $25,000, $25,000, $25,000 and $10,000 due on the 15th day of November 2013, March, 2014, June 2014, September 2014 and February 2015, respectively. The parties will also execute mutual releases. The Company had previously accrued $96,000 in connection with settlement of this litigation which is included in accounts payable and accrued liabilities on the accompanying balance sheet at June 30, 2013.

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

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

26. RECENTLY ISSUED ACCOUNTING STANDARD

In July 2013, the Financial Accounting Standards Board issued Accounting Standards Update No. 2013-11, "Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists". This update requires that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, unless the net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under applicable tax law or if the company does not intend to use the tax benefit towards the settlement of a disallowed tax position, if any.

This standard will become effective for interim periods and fiscal years beginning on or after December 15, 2013. Adoption of this standard is not expected to have a material effect on the Company's financial statements.

27. SUBSEQUENT EVENTS

Sale of Common Stock and Warrants

Subsequent to June 30, 2013, the Company made a private sale, pursuant to a stock purchase agreement of 333,333 unregistered shares of its common stock and 333,333 five-year, common stock warrants to purchase one share of its common stock at an exercise price of $0.03 per share in consideration for $10,000 received from the son of Richard W. Evans, a director.

Anti-dilution Shares issued to George J. Coates Related to New Shares of Common Stock Sold

Subsequent to June 30, 2013, the Company issued 1,928,763 unregistered shares of its common stock to George J. Coates for anti-dilution. The estimated value of these shares, based on the closing trading price of the stock on the dates of the issuances was $98,000. The Company also issued 2,793 shares of Series A Preferred Stock to Mr. Coates related to anti-dilution. The estimated fair value of these shares was $7,000.

Issuance of 12% Convertible Note

In August 2013, the Company issued a $28,000, 12% convertible note on the same terms and conditions as the other 12% convertible notes discussed in more detail in Note 14. The Company received cash proceeds of $25,000, which was net of an approximately 10.5% original issue discount. This note matures in August 2014, if not converted prior thereto.

Issuance of Convertible Promissory Note

In August 2013, the Company entered into a securities purchase agreement with an investor and issued an 8% convertible promissory note which matures in May 2014 and received cash proceeds of $50,000, net of financing costs of $3,000. This note contains the same terms and conditions as the previous 8% convertible promissory notes more fully discussed in Note 14.

Promissory Notes to Related Parties

Subsequent to June 30, 2013, the Company issued additional 17% promissory notes to George J. Coates and received proceeds therefrom of $2,000 and partially repaid $12,000 of these notes.

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

Issuance of Common Stock under Equity Line of Credit

Subsequent to June 30, 2013, the Company issued 1,765,430 registered shares of its common stock under the equity line of credit with Dutchess Opportunity Fund II, LP and received net proceeds of $60,000.

Deferred Compensation

Subsequent to June 30, 2013, George J. Coates, Barry C. Kaye and Bernadette Coates agreed to additional deferral of their compensation amounting to $29,000, $4,000 and $8,000, respectively, bringing their total deferred compensation to $135,000, $102,000 and $31,000, respectively.

Intention to Merge with China-Based Manufacturing and Casting Company

In August 2013, the Company signed a letter of commitment with a China-based manufacturer and casting company. This company also owns coal mining operations in China. The parties agreed to enter into negotiations and undertake due diligence with a mutual goal of merging the two companies for the purpose of establishing large scale production in China of industrial CSRV electric power generators. An important element in ensuring success of this transaction is that the Company intends to undertake a public offering in the U.S. and Hong Kong to raise US$300 - 500 million. As this transaction is at an early stage, there can be no assurance that it will be consummated.

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

Cautionary Notice Regarding Forward-Looking Statements

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

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

For a discussion of factors that we believe could cause our actual results to differ materially from expected and historical results see "Item 1A - Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2012 filed with the Securities and Exchange Commission.

Background

We have completed development of the Coates spherical rotary valve engine technology. This technology has been successfully applied to natural gas fueled industrial electric power generator engines, automobile engines, residential generators and high-performance racing car engines. We have been primarily investing our management time and resources in securing new working capital and developing plans for transitioning to large scale production in order to be properly positioned to take advantage of this technology as it achieves acceptance in the marketplace. This includes consideration of an optimal location, shipping logistics, manufacturing capacity and quality of the labor pool for such large scale manufacturing. In the second quarter of 2013, we also commenced research and development of a Hydrogen Reactor capable of generating Hydroxy Gas from an ordinary water supply, with a goal toward using the Hydroxy Gas to power our CSRV engines.

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

In July 2013, George J. Coates and his son Gregory Coates successfully completed research and development on a first generation Hydrogen Reactor, which is capable of splitting ordinary tap water molecules into Hydroxy Gas and Oxygen. The Hydroxy Gas is harvested from the tap water on demand by the hydrogen splitting reactor. It is our goal to power our Coates CSRV engines with the harvested Hydroxy Gas. The first generation Hydrogen Reactor is capable of powering a 14-horsepower CSRV engine.

CSRV engines operating on Hydroxy Gas do not produce any emissions, and the energy is sourced from an ordinary water supply, making this a relatively inexpensive and "green" source of power. Conventional engines designed with poppet valve assemblies would likely experience catastrophic failure in a very short time running on Hydroxy Gas because they are designed to run on gasoline or diesel fuel and there is no lubricity in Hydroxy Gas.

At this time, the Company is continuing with the development of this technology and is working on applying this technology to more powerful, higher capacity CSRV engines. George and Gregory Coates have agreed to grant us a license to the rights to this Hydrogen Reactor technology once it is applied to higher capacity engines. The consideration for this grant of license will be determined between the related parties. Once we obtain the licensing rights, we plan to commence production of CSRV products powered with this new technology. There can be no assurance that this technology can be successfully applied to such higher powered CSRV engines.

In July 2013, we announced our intention to spin off our manufacturing operations and grant a license to the rights to our intellectual property for the CSRV system technology to Coates Hi-Tech Engines, Ltd. (“Coates Hi-Tech”), a majority owned subsidiary. Coates Hi-Tech is currently in the process of raising new working capital in order to commence operations. Consummation of this spin-off transaction is dependent on the success in raising the new working capital. As consideration for the manufacturing operations and licensed rights, Coates Hi-Tech would be obligated to pay us $10,000,000 as follows: $1,000,000 from the new working capital to be raised by Coates Hi-Tech (as explained in more detail below) from the sale of up to $20 million of Coates Hi-Tech’s common stock and the balance in periodic installments from positive cash flow of Coates Hi-Tech in amounts that will not materially impact on the Coates Hi-Tech’s cash flow as determined by Coates Hi-Tech’s board of directors, in its sole discretion. The first $1 million portion of the fee due us will be paid as follows: 5% of the amount raised up to the first $10 million; and 50% of the next $1 million raised.

In the event this spin-off transaction is consummated, we would then hold approximately 11.3% of Coates Hi-Tech’ common stock. We would also hold all of Coates Hi-Tech’s super-voting preferred stock which would result in us controlling 76.38% of the eligible stockholder votes of Coates Hi-Tech.

Plan of Operation

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

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

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

Our ability to establish such manufacturing operations, recruit plant workers, finance initial manufacturing inventories and fund capital expenditures is highly dependent on our ability to successfully raise substantial new working capital in an amount and at a pace which matches our business plans. Possible sources of such new working capital include, sales of our common stock and warrants through private transactions, issuances of promissory notes to related parties, issuances of convertible promissory notes, sales of shares of our common stock through the equity line of credit arrangement with Dutchess Opportunity Fund II, LP, sales of CSRV products, sales of our equity and/or debt securities through private placement offerings, pursuing and entering into additional sublicensing agreements with OEM's and/or distributors and additional Release Payments from Almont. There can be no assurance that we will be successful in raising adequate new working capital or even any new working capital to carry out our business plans. The current economic environment, which is characterized by tight credit markets, investor uncertainty about how to safely invest funds and low investor confidence has introduced additional risk and difficulty to our challenge to secure such additional working capital.

Significant Estimates

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

Recent Developments

Intention to Merge with China-Based Manufacturing and Casting Company

In August 2013, we signed a letter of commitment with a China-based manufacturer and casting company. This company also owns coal mining operations in China. The parties agreed to enter into negotiations and undertake due diligence with a mutual goal of merging the two companies for the purpose of establishing large scale production in China of industrial CSRV electric power generators. An important element in ensuring success of this transaction is that we intend to undertake a public offering in the U.S. and Hong Kong to raise US$300 - 500 million. As this transaction is at an early stage, there can be no assurance that it will be consummated.

Results of Operations

Three Months Ended June 30, 2013 Compared to the Three Months Ended June 30, 2012 (All amounts rounded to thousands of dollars)

Our principal business activities and efforts for the three months ended June 30, 2013 and 2012 were devoted to (i) undertaking efforts to raise additional working capital in order to fund the start-up of large scale manufacturing operations, (ii) preparing applications to, and negotiating with certain states, with the objective of securing a package of business, finance and tax incentives they may be offering to new businesses willing to relocate their operations in order to stimulate their economy and create new jobs within the state; and (iii) developing plans for transitioning to large scale manufacturing. In addition, during the three months ended June 30, 2013, research and development was under way to develop and apply the aforementioned new

Hydrogen Reactor technology to power a CSRV engine. During the three months ended June 30, 2012, we were also engaged, to a limited extent, in research and development activities related to applying the CSRV technology to industrial engines.

Although we incurred substantial net losses for the three months ended June 30, 2013 and 2012 of $1,176,000 and $1,489,000, respectively, it is important to consider that a substantial portion of these losses resulted from non-cash expenses required to be recorded for financial reporting purposes in accordance with GAAP. These net losses should be considered in view of the fact that actual cash used for operations was significantly less than these net losses. Cash used for operations amounted to ($185,000) and ($280,000) in the 2013 and 2012 period, respectively.

Revenues

There were no sales and no revenues from research and development for the three months ended June 30, 2013 and 2012.

Sublicensing fee revenue for the three months ended June 30, 2013 and 2012, amounted to $5,000 and $5,000, respectively. The Company is recognizing the license deposit of $300,000 on the Canadian License with Almont as revenue over the approximately 16-year remaining life of the last CSRV technology patent in force at the date amortization began.

Operating Expenses

Research and Development Expenses

In the second quarter of 2013, the Company commenced research and development of the Hydrogen Reactor. Research and development expenses in 2012 related to applying the CSRV technology to industrial engines. There were no research and development activities in the first quarter of 2013. Research and development expenses for the three months ended June 30, 2013 and 2012 amounted to $79,000 and $136,000, respectively. Included in research and development expenses for the three months ended June 30, 2013 and 2012 was $60,000 and $47,000, respectively, of allocated compensation and benefits, $14,000 and $88,000, respectively, of allocated stock-based compensation expense and $5,000 and $1,000, respectively, of parts and materials.

General and Administrative Expenses

General and administrative expenses decreased to $570,000 for the three months ended June 30, 2013 from $1,209,000 in the corresponding period in 2012. This net decrease of $639,000 primarily resulted from the following: A decrease in non-cash stock-based compensation expense of $589,000, a decrease in compensation and benefits of $26,000, a decrease in patent maintenance of $23,000, a decrease in insurance of $8,000, a decrease in printing expenses of $6,000, a decrease in marketing expenses of $6,000, a decrease in dues and subscriptions of $5,000 and a net decrease in other expenses of $2,000, partially offset by an increase in legal and professional fees and expenses of $15,000, an increase in costs to comply with S.E.C. rules and regulations for publicly reporting companies of $7,000 and an increase in office expenses of $4,000.

Depreciation and Amortization

Depreciation and amortization increased by $5,000 to $15,000 for the three months ended June 30, 2013 from $10,000 for the three months ended June 30, 2012.

Other Income (Expense)

Other income (expense) for the three months ended June 30, 2013 and 2012, consisted of an (increase) in the fair value of embedded derivative liabilities amounting to ($413,000) and ($37,000), respectively and interest expense of ($102,000) and ($99,000), respectively.

Provision for Income Taxes

The change in deferred tax assets for the three months ended June 30, 2013 and 2012 was fully offset by a valuation allowance, resulting in a $-0- net income tax provision.

Net Loss

We incurred net losses of ($1,176,000) and ($1,489,000) for the three months ended June 30, 2013 and 2012, respectively.

Six Months Ended June 30, 2013 Compared to the Six Months Ended June 30, 2012 (All amounts rounded to thousands of dollars)

Our principal business activities and efforts for the six months ended June 30, 2013 and 2012 were devoted to (i) undertaking efforts to raise additional working capital in order to fund the start-up of large scale manufacturing operations, (ii) preparing applications to, and negotiating with certain states, with the objective of securing a package of business, finance and tax incentives they may be offering to new businesses willing to relocate their operations in order to stimulate their economy and create new jobs within the state; and (iii) developing plans for transitioning to large scale manufacturing. In addition, during the six months ended June 30, 2013, research and development was under way to develop and apply the aforementioned new Hydrogen Reactor technology to power a CSRV engine. During the six months ended June 30, 2012, we were also engaged, to a limited extent, in research and development activities related to applying the CSRV technology to industrial engines.

Although we incurred substantial net losses for the six months ended June 30, 2013 and 2012 of $1,982,000 and $2,888,000, respectively, it is important to consider that a substantial portion of these losses resulted from non-cash expenses required to be recorded for financial reporting purposes in accordance with GAAP. These net losses should be considered in view of the fact that actual cash used for operations was significantly less than these net losses. Cash used for operations amounted to ($374,000) and ($642,000) in the 2013 and 2012 period, respectively. Included in the net losses for financial reporting purposes for the six months ended June 30, 2013 and 2012 was non-cash stock-based compensation expense of $613,000 and $1,728,000, respectively, $483,000 and $9,000 of non-cash expense from the change in the estimated fair value of embedded derivative liabilities related to convertible promissory notes, respectively, unpaid accrued interest expense of $133,000 and $244,000, respectively and $129,000 and $-0- of deferred compensation expense, respectively.

Revenues

There were no sales and no revenues from research and development for the six months ended June 30, 2013 and 2012.

Sublicensing fee revenue for the six months ended June 30, 2013 and 2012, amounted to $10,000 and $10,000, respectively. The Company is recognizing the license deposit of $300,000 on the Canadian License with Almont as revenue over the approximately 16-year remaining life of the last CSRV technology patent in force at the date amortization began.

Operating Expenses

Research and Development Expenses

In the second quarter of 2013, the Company commenced research and development of the Hydrogen Reactor. There were no research and development activities in the first quarter of 2013. Research and development expenses in 2012 related to applying the CSRV technology to industrial engines. Research and development expenses for the six months ended June 30, 2013 and 2012 amounted to $79,000 and $322,000, respectively. Included in research and development expenses for the six months ended June 30, 2013 and 2012 was $60,000 and $101,000, respectively, of allocated compensation and benefits, $14,000 and $176,000, respectively, of allocated stock-based compensation expense and $5,000 and $45,000, respectively of parts and materials.

General and Administrative Expenses

General and administrative expenses decreased to $1,194,000 for the six months ended June 30, 2013 from $2,265,000 in the corresponding period in 2012. This net decrease of $1,071,000 primarily resulted from the following: A decrease in non-cash stock-based compensation expense of $952,000, a decrease in legal and professional fees and expenses of $75,000, a decrease in investor relations expenses of $37,000, a decrease in patent maintenance costs of $13,000, a decrease in insurance costs of $10,000, a decrease in marketing expenses of $7,000, a decrease in dues and subscriptions of $5,000, a decrease in printing costs of $4,000, a decrease in tools expense of $3,000, a decrease in miscellaneous income/(expense) of $3,000 and a decrease in postage costs of $2,000, partially offset by an increase in compensation and benefits of $15,000 as no compensation and benefits costs were allocated to research and development expenses in the first quarter of 2013, an increase in real estate taxes of $13,000, an increase in costs to comply with S.E.C. rules and regulations for publicly reporting companies of $9,000, an increase in utilities expenses of $4,000 and an increase in office expenses of $2,000.

Depreciation and Amortization

Depreciation and amortization increased by $7,000 to $33,000 for the six months ended June 30, 2013 from $26,000 for the six months ended June 30, 2012.

Other Income (Expense)

Other income (expense) for the six months ended June 30, 2013 and 2012, consisted of an (increase) in the fair value of embedded derivative liabilities amounting to ($483,000) and ($9,000), respectively and interest expense of ($202,000) and ($276,000), respectively.

Provision for Income Taxes

The change in deferred tax assets for the six months ended June 30, 2013 and 2012 was fully offset by a valuation allowance, resulting in a $-0- net income tax provision.

Net Loss

We incurred net losses of ($1,982,000) and ($2,888,000) for the six months ended June 301, 2013 and 2012, respectively.

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

Our cash position at June 30, 2013 was $8,000, a decrease of $5,000 from the cash position of $13,000 at December 31, 2012. We had negative working capital of ($5,110,000) at June 30, 2013, which represents a $783,000 improvement from the ($5,893,000) of negative working capital at December 31, 2012. Current liabilities of $5,241,000 at June 30, 2013, decreased by $793,000 from the $6,034,000 balance at December 31, 2012. Current liabilities were primarily comprised of accounts payable and accrued liabilities of $2,072,000, a mortgage loan in the amount of $1,540,000, promissory notes to related parties totaling $651,000, embedded derivative liabilities related to convertible promissory notes of $628,000, deferred compensation payable of $280,000, net carrying value of convertible promissory notes of $52,000 and unearned revenue of $19,000.

Operating activities utilized cash of ($374,000) during the six months ended June 30, 2013, which primarily consisted of a net loss for the period of ($1,982,000), decreased by non-cash stock-based compensation expense of $614,000, a $483,000 non-cash increase in the estimated fair value of embedded derivative liabilities related to convertible promissory notes, non-cash interest expense of $133,000, an increase in deferred salaries of $129,000, depreciation and amortization of $33,000 and non-cash financing costs of $5,000, partially offset by non-cash sublicensing revenues of ($10,000). In addition, we realized net additional operating cash of $221,000 from a net increase in accounts payable and accrued liabilities of $220,000 and a net decrease in deferred offering costs and other assets of $1,000.

There were no investing activities for the six months ended June 30, 2013.

Financing activities generated net cash of $368,000 for the six months ended June 30, 2013, consisting of proceeds from issuance of convertible notes amounting to $160,000, proceeds from issuance of promissory notes to related parties, net of repayments amounting to $143,000, proceeds from issuance of common stock and warrants of $95,000 and proceeds from issuance of common stock under an equity line of credit of $5,000, offset by a $35,000 partial repayment of the principal amount of a mortgage loan.

In the opinion of management, we will be required to raise additional working capital to fully achieve our objectives to enter the production phase of our operations. Various potential sources of such additional working capital are anticipated to come from one or more of the following: issuances of convertible promissory notes, issuances of promissory notes to related parties, private sales of common stock and common stock warrants and sales of shares of common stock to Dutchess Opportunity Fund II, LP under the equity line of credit. In addition, if Coates Hi-Tech is successful in raising new working capital, the Company would receive consideration as previously discussed, for the contribution of its manufacturing operations and grant of license in the CSRV technology.

Going Concern

We have incurred net recurring losses since inception, amounting to ($33,209,000), as of June 30, 2013, primarily consisting of research and development expenses and had a stockholders' deficiency of ($3,178,000). These research and development expenses which were incurred to develop the CSRV sytem technology could begin to create value if we are able to raise sufficient working capital and commence production of our CSRV engines. We will need to obtain additional working capital in order to continue to cover our ongoing cash expenses.

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

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

During the six months ended June 30, 2013, we raised additional working capital of $403,000, consisting of proceeds, net of repayments, from issuances of promissory notes to George J. Coates and Bernadette Coates, spouse of George J. Coates amounting to $82,000 and $61,000, respectively, net proceeds from issuances of convertible promissory notes aggregating of $160,000, proceeds from sales of common stock and warrants to the son of Dr. Richard W. Evans, a director, of $95,000 and sales of common stock under an equity line of credit of $5,000.

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

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

New Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board issued Accounting Standards Update No. 2013-11, "Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists". This update requires that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, unless the net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under applicable tax law or if the company does not intend to use the tax benefit towards the settlement of a disallowed tax position, if any.

This standard will become effective for interim periods and fiscal years beginning on or after December 15, 2013. Adoption of this standard is not expected to have a material effect on our financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Smaller reporting companies are not required to provide such information.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls

Pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934 (the "Exchange Act"), we carried out an evaluation, with the participation of our management, including our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") (our principal financial and accounting officer), of the effectiveness of our disclosure controls and procedures (as defined under Rule 13a-15(e) under the Exchange Act) as of the end of the period covered by this report. Based upon that evaluation, our CEO and CFO concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

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

Mark D. Goldsmith, a former executive of the Company, filed a lawsuit against the Company in January 2008 in which he asserted that we were liable to him for breach of an employment contract. On August 14, 2013, the parties agreed on the terms of a tentative settlement. A final settlement agreement has not yet been executed. According to the main provisions of the settlement, the Company agreed to pay the plaintiff $125,000 in five installments of $40,000, $25,000, $25,000, $25,000 and $10,000 due on the 15th day of November 2013, March, 2014, June 2014, September 2014 and February 2015, respectively. The parties will also execute mutual releases. The Company had previously accrued $96,000 in connection with settlement of this litigation which is included in accounts payable and accrued liabilities on the accompanying balance sheet at June 30, 2013.

Item 1A. Risk Factors

We believe there are no changes that constitute material changes from the risk factors previously disclosed in the Company's 2012 Annual Report filed on Form 10-K.

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

The following issuances of securities during the three months ended June 30, 2013 were exempt from registration pursuant to Section 4(2), and Regulation D promulgated under the Securities Act. We made this determination based on the representations of the Investors which included, in pertinent part, that such Investors were "accredited investors" within the meaning of Rule 501 of Regulation D promulgated under the Securities Act, and that such Investors were acquiring our common stock, for investment purposes for their own respective accounts and not as nominees or agents, and not with a view to the resale or distribution thereof, and that the Investors understood that the shares of our common stock may not be sold or otherwise disposed of without registration under the Securities Act or an applicable exemption therefrom.

In a series of transactions, we made private sales, pursuant to stock purchase agreements of 2,833,334 unregistered shares of our common stock and 2,833,334 five-year common stock warrants to purchase one unregistered share of our common stock at exercise prices ranging from $0.015 to $0.025 per share in consideration for $60,000 received from the son of Dr. Richard W. Evans, a director.

In a series of transactions, we issued 5,507,876 unregistered shares of our common stock to George J. Coates for anti-dilution protection related to new shares of common stock issued in 2013. The estimated value of these shares, based on the closing trading price of the stock on the dates of issuance was $119,000.

On April 19th and June 4th, we issued $43,000 and $32,000 principal amount, 8% convertible promissory notes, respectively, to an accredited investor and received cash proceeds of $70,000, net of closing costs. The lender may convert the promissory notes into unregistered shares of the Company's common stock at any time beginning 180 days after the date of funding. The conversion rate is equal to 61% of the average of the three lowest closing bid prices of the stock during the ten trading days prior to the date of conversion.

On June 2, 2013, we issued a $28,000 principal amount, 12% convertible promissory note to another accredited investor and received cash proceeds of $25,000. The lender may convert the promissory notes into unregistered shares of the Company's common stock at any time beginning 180 days after the date of funding. The conversion rate shall be equal to the lesser of $0.035 per share or 60% of the lowest trading price of the common stock in the 25 trading days prior to the date of conversion.

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

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

The information required to be contained in this Item is incorporated by reference to Part II. Item 1 of this Quarterly Report on Form 10-Q under the heading "Legal Proceedings."

Item 6. Exhibits

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

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

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

SIGNATURES

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

	COATES INTERNATIONAL, LTD.
Date: August 15, 2013	*/s/ George J. Coates*
	George J. Coates Duly Authorized Officer, President and Chief Executive Officer (Principal Executive Officer)
Date: August 15, 2013	*/s/ Barry C. Kaye*
	Barry C. Kaye Duly Authorized Officer, Treasurer and Chief Financial Officer (Principal Financial and Accounting Officer)