

CoroWare, Inc,
Form 10-Q
June 08, 2011

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

FORM 10-Q

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

For the quarterly period ended March 31, 2011

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER: 000-33231

COROWARE, INC.
(EXACT NAME OF THE COMPANY AS SPECIFIED IN ITS CHARTER)

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

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

(800) 641-2676
(ISSUER REGISTRANT TELEPHONE NUMBER)

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

Indicate by check mark whether the 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 (Do not check if a smallerSmaller reporting company reporting company

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

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

As of June 6, 2011 there were 631,289,576 shares of the issuer's \$.001 par value common stock outstanding.

-1-

COROWARE, INC.
March 31, 2011 QUARTERLY REPORT ON FORM 10-Q

TABLE OF CONTENTS

| | PAGE |
|--|------|
| PART I – FINANCIAL INFORMATION | |
| Item 1. Consolidated Financial Statements | 3 |
| Consolidated Balance Sheets at March 31, 2011 (Unaudited) and December 31, 2010 | 3 |
| Unaudited Consolidated Statements of Operations for the three months ended March 31, 2011 and 2010 | 4 |
| Unaudited Consolidated Statements of Cash Flows for the three months ended March 31, 2011 and 2010 | 5 |
| Notes to Unaudited Consolidated Financial Statements | 7 |
| Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations | 15 |
| Item 3. Quantitative and Qualitative Disclosures About Market Risk | 17 |
| Item 4. Controls and Procedures | 17 |
| PART II – OTHER INFORMATION | |
| Item 1. Legal Proceedings | 18 |
| Item 1A. Risk Factors | 18 |
| Item 2. Unregistered Sales of Equity Securities and Use of Funds | 18 |
| Item 3. Defaults Upon Senior Securities | 18 |
| Item 4. Removed and Reserved | 18 |
| Item 5. Other Information | 18 |
| Item 6. Exhibits | 18 |
| SIGNATURES | 19 |

COROWARE, INC.
CONSOLIDATED BALANCE SHEETS

| | March 31, 2011 (Unaudited) | December 31, 2010 |
|--|----------------------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash | \$- | \$- |
| Accounts receivable, net | 118,410 | 188,988 |
| Inventory | 5,411 | 4,818 |
| Other current assets | 15,124 | 10,673 |
| Total current assets | 138,945 | 204,479 |
| Property and equipment, net | 28,391 | 31,391 |
| Intangible assets, net | 4,431 | 11,081 |
| Other assets, net | 8,619 | 4,731 |
| TOTAL ASSETS | \$180,386 | \$251,682 |
| LIABILITIES AND STOCKHOLDERS' DEFICIT | | |
| Current liabilities: | | |
| Lines of credit | \$126,572 | \$124,991 |
| Obligations collateralized by receivables | 66,133 | 102,389 |
| Accounts payable and accrued expenses | 3,890,580 | 3,811,415 |
| Accrued expenses, related parties | 182,751 | 150,536 |
| Notes payable | 257,732 | 263,133 |
| Notes payable, related parties | 280,312 | 292,812 |
| Derivative liability | 996,886 | 1,825,216 |
| Current maturities of convertible debt, net of discount | 2,136,607 | 2,292,410 |
| Redeemable preferred stock, Series B, \$.001 par value, 10,000,000 shares authorized, 159,666 shares issued and outstanding as of | | |
| March 31, 2011 and December 31, 2010 | 212,887 | 260,958 |
| Small Business Administration Loan | 981,450 | 982,450 |
| Total current liabilities | 9,131,910 | 10,106,310 |
| Long term liabilities: | | |
| Convertible debt, net of discount and current portion | 106,134 | - |
| Total liabilities | 9,238,044 | 10,106,310 |
| Commitments | | |
| Stockholders' deficit: | | |
| Common stock, \$.001 par value, 900,000,000 shares authorized, 347,224,535 and 88,590,637 shares issued and 347,223,701 and 88,589,803 outstanding at March 31, 2011 and | | |
| December 31, 2010, respectively | 347,224 | 88,591 |
| Additional paid-in capital | 15,679,177 | 15,530,450 |

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

| | | |
|--|-------------------|-------------------|
| Accumulated deficit | (25,048,359) | (25,437,969) |
| Treasury stock | (35,700) | (35,700) |
| Total stockholders' deficit | (9,057,658) | (9,854,628) |
| TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT | \$ 180,386 | \$ 251,682 |

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

-3-

COROWARE, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three Months ended March 31, 2011 and 2010
(Unaudited)

| | 2011 | 2010 |
|--------------------------------------|---------------|------------|
| Revenues | \$370,504 | \$545,809 |
| Cost of revenues | 262,314 | 440,436 |
| Gross profit | 108,190 | 105,373 |
| Operating expenses: | | |
| General and administrative | 324,452 | 221,777 |
| Sales and marketing | 78,673 | 30,714 |
| Research & development | 45,739 | - |
| Depreciation and amortization | 9,650 | 10,250 |
| Total operating expenses | 458,514 | 262,741 |
| Loss from operations | (350,324) | (157,368) |
| Other income (expense): | | |
| Derivative income | 899,569 | 936,711 |
| Interest expense, net | (175,097) | (277,381) |
| Gain on debt redemptions | 15,462 | 21,958 |
| Total other income | 739,934 | 681,288 |
| Net income | \$389,610 | \$523,920 |
| Net income per share: | | |
| Basic | \$0.00 | \$0.08 |
| Diluted | \$0.00 | \$0.07 |
| Weighted average shares outstanding: | | |
| Basic | 205,664,039 | 6,894,901 |
| Diluted | 1,580,035,894 | 7,157,401 |

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

COROWARE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Three Months Ended March 31, 2011 and 2010
(Unaudited)

| | 2011 | 2010 |
|---|-------------------|-------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | \$389,610 | \$523,920 |
| Adjustments to reconcile net income to net cash flows from operating activities: | | |
| Depreciation and amortization | 9,650 | 10,250 |
| Stock option expense | - | 7,043 |
| Amortization of debt discount | 21,575 | 59,444 |
| Amortization of deferred financing costs | 1,112 | 6,250 |
| Derivative income | (899,569) | (936,711) |
| Gain on debt redemptions | (15,462) | (21,958) |
| Common stock issued for services | 3,300 | 33,822 |
| (Gain) loss on settlement of liabilities with stock | 75,134 | (12,798) |
| Gain on partial settlement of mortgage note | - | (6,650) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | 70,578 | 59,699 |
| Other current assets, net | (5,044) | 15,865 |
| Accounts payable and accrued expenses Accrued expenses, related parties | 304,826 30,657 | 274,369 28,562 |
| NET CASH FLOWS FROM OPERATING ACTIVITIES | (13,633) | 41,107 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Additions to property and equipment | - | - |
| NET CASH FLOWS FROM INVESTING ACTIVITIES | - | - |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Obligations collateralized by receivables | (36,256) | - |
| Proceeds from lines of credit, net | 1,581 | 984 |
| Payments on notes payable | (8,692) | (40,000) |
| Payments on notes payable, related parties | - | (5,097) |
| Payments on long-term debt | (1,000) | - |
| Proceeds from convertible debentures, net of financing costs | 43,000 | - |
| Proceeds from notes payable | 15,000 | - |
| Proceeds from notes payable, related party | - | 20,000 |
| NET CASH FLOWS FROM FINANCING ACTIVITIES | 13,633 | (24,113) |
| NET INCREASE IN CASH | - | 16,994 |
| Cash, beginning of period | - | 3,493 |
| Cash, end of period | \$- | \$20,487 |

Continued.

COROWARE, INC.
 CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
 For the Three Months Ended March 31, 2011 and 2010
 (Unaudited)

| | 2011 | 2010 |
|--|-----------|----------|
| SUPPLEMENTAL CASH FLOW INFORMATION | | |
| Interest paid | \$- | \$- |
| Income taxes paid | \$- | \$- |
| NON-CASH INVESTING AND FINANCING TRANSACTIONS | | |
| Common stock issued for redemption of convertible debentures | \$79,056 | \$69,965 |
| Common stock issued in satisfaction of accrued liabilities | \$246,401 | \$67,713 |
| Common stock issued in satisfaction of note payable | \$78,604 | \$- |

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

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

NOTE 1 – BASIS OF PRESENTATION

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

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Recent Accounting Pronouncements

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

NOTE 3 – FINANCIAL CONDITION AND GOING CONCERN

The Company has loss from operations for the three months ended March 31, 2011 of \$350,324. Because of these losses, the current working capital deficit, and the projection of additional losses for the remainder of 2011, the Company will require additional working capital to develop its business operations.

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

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

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

NOTE 4 – ACCOUNTS RECEIVABLE FACTORING

In March 2010, the Company entered into an accounts receivable factoring arrangement with Capefirst Funding, LLC. (“Capefirst”). The agreement calls for Capefirst to advance up to 80% of the net face amount of each assigned account or up to 50% of eligible assigned purchase orders. The agreement calls for a maximum facility amount of \$200,000 with a purchase fee of 2% of the net face amount of each assigned account and a collection fee of 0.1% compounded daily. In the event of a dispute or in the event of fraud, misrepresentation, willful misconduct or negligence on the part of the Company, Capefirst may require the Company to immediately repurchase the assigned accounts at a purchase price that includes the amount of the assigned account plus the discount fee, interest and collection fee and may include a processing fee of 10%. At March 31, 2011, approximately \$66,133 of our receivables had been factored.

NOTE 5 – NOTES PAYABLE

On March 15, 2011, the Company entered into a \$15,000 note payable with an unrelated third party. The note bears interest at 18.99% through maturity at March 25, 2011 with default interest of 28.99%. The note is secured by a security interest in substantially all assets of the Company.

During the quarter ended March 31, 2011, notes payable and accrued interest aggregating \$78,604 were converted into 73,364,837 shares of common stock of the Company.

NOTE 6 - CONVERTIBLE DEBT

The following table illustrates the carrying value of convertible debt:

| | March 31, 2011 | December 31, 2010 |
|---------------------------------|-------------------|----------------------|
| \$2,825,000 financing | \$1,212,997 | \$1,380,141 |
| March 18, 2011 modification (a) | 106,134 | - |
| \$ 600,000 financing | 600,000 | 600,000 |
| \$ 300,000 financing | 300,000 | 300,000 |
| \$ 75,000 financing | 7,788 | 12,269 |
| \$ 27,500 financing (b) | 4,297 | - |
| \$ 10,750 financing (c) | 2,004 | - |
| \$ 9,750 financing (d) | 9,521 | - |
| | \$2,242,741 | \$2,292,410 |

Total unamortized debt discount was \$300,809 and \$62,731 for the period ended March 31, 2011 and the year ended December 31, 2010.

(a) March 18, 2011 modification

As discussed in the December 31, 2010 10K, Yorkville Advisors transferred a 46.3% portion of Tranche 1 of the \$2,825,000 debenture to a third party effective December 31, 2010. The assignment aggregated \$568,263, representing \$341,123 of unpaid principal and \$227,140 of accrued interest. At that time, there was no accounting impact for CoroWare as it was merely an assignment between debt holders. On March 18, 2011, the third party debt holder that received the 46.3% share modified the terms of the debenture such that the interest rate was lowered from 14% to 5% and the maturity date was extended until March 18, 2013. Simultaneously, the conversion rate on the debenture was modified from 85% of the 30 day Volume Weighted Average Price (“VWAP”) to 65% of the 30 day VWAP.

The modification was analyzed in accordance with current accounting standards and was determined not to be a troubled debt restructuring or an extinguishment of debt. As such, it was accounted for as a modification and no gain or loss was recognized on the transaction. A debt discount of \$236,779 was recognized for the difference in the fair value of the embedded conversion feature before and after the modification date. A new effective rate was calculated for the new debenture and the related debt discount is being amortized using the effective interest rate over the new 2 year term of the underlying loan. Amortization for the period ended March 31, 2011 was \$2,397.

On March 21, 2011, this third party transferred 50% of his ownership interest in this debenture to another unrelated party. The terms of the debenture did not change with that transfer. As such, this transfer was also considered an assignment between debt holders and did not have an accounting impact on the Company. No conversions were made on either of these debentures during the quarter ending March 31, 2011.

With the extension of the maturity date, this note is not longer in default and has been reclassified to long-term liabilities on the face of the accompanying balance sheets. The remaining financings with Yorkville have matured and are currently in default. As such, all amounts of unpaid principal and interest are due and payable.

(b) \$27,500 financing

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

The debenture matures on the November 3, 2011, nine months from the date of issuance. The holder of the debenture may, at any time, convert amounts outstanding under the debenture into shares of common stock of the Company at a conversion rate equal to 51% of the market price, which is defined as the lowest 3 trading prices for the Company's common stock during the 10 trading days prior to conversion. The Company's obligations under the purchase agreement are secured by substantially all of the assets of the Company and those of its wholly owned subsidiary, CoroWare Technologies, Inc.

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

(c) \$10,750 financing

On January 28, 2011, the Company consummated a Secured Convertible Promissory Note with an unrelated third party for \$10,750, net of deferred financing costs of \$2,500.

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

In the Company's evaluation of this instrument in accordance with ASC 815 Derivatives and Hedging, based on the variable conversion price and lack of authorized shares, it was determined that the conversion feature was not afforded the exemption as a conventional convertible instrument and did not otherwise meet the conditions for equity

classification. As such, the conversion and other features were compounded into one instrument, bifurcated from the debt instrument and carried as a derivative liability, at fair value. The Company estimated the fair value of the bifurcated derivative instruments using the Monte Carlo valuation model because this methodology provides for all of the necessary assumptions necessary for fair value determination; including assumptions for credit risk, interest risk and conversion/redemption behavior. Significant assumptions underlying this methodology were: effective term (using the remaining term of the host instrument); effective volatility (155.39% - 117.57%); and effective risk adjusted yield (12.5%). as a result of these estimates, the valuation model resulted in a compound derivative balance of \$12,369 at inception. Derivative expense of \$1,619 was recognized at inception.

(d) \$9,750 financing

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

-9-

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

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

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

| | Three Months ended March 31, 2011 | | | |
|-----------------------------|-----------------------------------|-------------|--------------|-----------|
| | Fair Value | | | |
| Derivative income (expense) | Inception | Adjustments | Redemptions | Total |
| \$2,825,000 financing | \$- | \$ 602,113 | \$ (11,093) | \$591,020 |
| March 18, 2011 modification | - | 135,040 | - | 135,040 |
| \$ 600,000 financing | - | 157,233 | - | 157,233 |
| \$ 300,000 financing | - | 26 | - | 26 |
| \$ 75,000 financing | - | (2,634) | (17,127) | (19,761) |
| \$ 27,500 financing | (9,229) | (586) | - | (9,815) |
| \$ 10,750 financing | (1,619) | 3,040 | - | 1,421 |
| \$ 9,750 financing | - | (3,666) | - | (3,666) |
| Preferred stock, Series B | - | 48,071 | - | 48,071 |
| | \$(10,848) | \$ 938,637 | \$ (28,220) | \$899,569 |

| | Three Months ended March 31, 2010 | | | |
|-----------------------------|-----------------------------------|-------------|--------------|-----------|
| | Fair Value | | | |
| Derivative income (expense) | Inception | Adjustments | Redemptions | Total |
| \$2,825,000 financing | \$- | \$ 666,182 | \$ (21,703) | \$644,479 |
| \$ 600,000 financing | - | 217,412 | - | 217,412 |
| \$ 300,000 financing | - | 597 | - | 597 |
| Preferred stock, Series B | - | 74,223 | - | 74,223 |
| | \$- | \$ 958,414 | \$ (21,703) | \$936,711 |

The following table illustrates the components of derivative liabilities:

| | As of March 31, 2011 | | |
|-----------------------------|------------------------|----------------------|-----------|
| | Compound Derivative | Warrant Liability | Total |
| \$2,825,000 financing | \$442,906 | \$6 | \$442,912 |
| March 18, 2011 modification | 243,802 | - | 243,802 |
| \$ 600,000 financing | 213,251 | 2,250 | 215,501 |
| \$ 300,000 financing | - | 1 | 1 |
| \$ 75,000 financing | 40,870 | - | 40,870 |
| \$ 27,500 financing | 37,315 | - | 37,315 |
| \$ 10,750 financing | 9,329 | - | 9,329 |
| \$ 9,750 financing | 7,156 | - | 7,156 |
| | \$994,629 | \$2,257 | \$996,886 |

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

The following table summarizes the number of common shares indexed to the derivative financial instruments as of March 31, 2011:

| Financing or other contractual arrangement: | Conversion | | |
|---|---------------|-----------|---------------|
| | Features | Warrants | Total |
| \$2,825,000 Convertible note financing | 2,214,527,782 | 8,333 | 2,214,536,115 |
| March 18, 2011 modification | 812,672,113 | - | 812,672,113 |
| \$ 600,000 Convertible note financing | 982,721,461 | 7,500,000 | 990,221,461 |
| \$ 300,000 Convertible note financing | 70,942 | 33,333 | 104,275 |
| \$ 75,000 Convertible note financing | 113,843,226 | - | 113,843,226 |
| \$ 27,500 Convertible note financing | 91,011,729 | - | 91,011,729 |
| \$ 10,750 Convertible note financing | 27,849,127 | - | 27,849,127 |
| \$ 9,750 Convertible note financing | 17,369,946 | - | 17,369,946 |
| | 4,260,066,326 | 7,541,666 | 4,267,607,992 |

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

During the three months ended March 31, 2011 conversions were as follows:

| Financing or other contractual arrangement: | Principal converted | Shares Issued | Gain Recorded |
|---|---------------------|---------------|---------------|
| \$2,825,000 Convertible note financing | \$34,700 | 19,136,746 | \$14,496 |
| \$ 75,000 Convertible note financing | 20,290 | 21,500,000 | 966 |
| | \$54,990 | 40,636,746 | \$15,462 |

As noted above, a portion of the \$2,825,000 convertible note financing is in default in addition to the \$600,000 and \$300,000 convertible note financings. However, the terms of the agreements allow conversion of the debt during periods of default. In computing the derivative liability associated with the conversion, one of the inputs is maturity of the instruments which, in this case, is technically in the past. Accordingly, management has estimated a debt maturity date of ten months from the period-end date for purposes of the derivative liability calculations.

NOTE 7 - OTHER STOCKHOLDERS' EQUITY

a) Stock Options:

The following table summarizes stock option activity:

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

b) Outstanding warrants:

At March 31, 2011, the Company had the following warrants outstanding:

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

c) Issuance of common stock:

The following table summarizes common stock issued for services during the three month period ended March 31:

| | 2011 | | 2010 | |
|-----------------------|-----------|---------|---------|----------|
| | Shares | Value | Shares | Value |
| Employee compensation | 1,000,000 | \$3,300 | 509,600 | \$20,006 |
| Professional fees | - | - | 337,118 | \$13,816 |
| | 1,000,000 | \$3,300 | 846,718 | \$33,822 |

The following table summarizes other common stock issued during the three month period ended March 31:

| | 2011 | | 2010 | |
|-------------------------------------|-------------|-----------|-----------|-----------|
| | Shares | Value | Shares | Value |
| Satisfaction of payables | 143,631,315 | \$246,401 | 1,890,180 | \$67,713 |
| Redemption of convertible debenture | 40,636,746 | 79,056 | 2,002,365 | 69,965 |
| Notes payable | 73,364,837 | 78,604 | - | - |
| | 257,632,898 | \$404,061 | 3,892,545 | \$137,678 |

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

d) Dividends on preferred stock:

At March 31, 2011 and December 31, 2010, there were cumulative undeclared dividends to Preferred Series B shareholders of \$33,929 and \$31,933, respectively, the obligation for which is contingent on declaration by the board of directors.

NOTE 8 – RELATED PARTY TRANSACTIONS

During the period ended March 31, 2011, a related party note holder sold the \$17,500 remaining balance of his note to an unrelated party.

NOTE 9 – COMMITMENTS

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

Future non-cancelable minimum lease payments are as follows:

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

NOTE 10 – SUBSEQUENT EVENTS

(1) Assignment of Convertible Note:

On April 12, 2011, Yorkville assigned a portion of the \$2,825,000 convertible note financing to an unrelated third party. The assignment aggregated \$885,710, representing \$567,200 of unpaid principal and \$318,510 of accrued interest. The terms and conditions of the note did not change.

(2) Stock Issuances:

The Company issued the following shares subsequent to March 31, 2011:

| | |
|--|-------------|
| Shares issued for employee compensation | 21,602,600 |
| Shares issued for in satisfaction of payables | 7,860,100 |
| Shares issued in connection with redemptions of convertible debentures | 254,603,175 |
| | 284,065,875 |

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

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

BACKGROUND

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

COROWARE TECHNOLOGIES, INC.

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

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

CoroWare Technologies comprises three separately managed lines of business:

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

The Company's revenues are principally derived from standing contracts that include Microsoft (partner management and IT professional services), a European auto manufacturer (simulation software custom development), and other customers whose product development groups require custom software development and consulting companies. Existing contract revenues vary month by month based on the demands of the clients. The Company's telepresence

effort is in the early stages of growth and will require additional working capital to compete effectively against new entrants in this rapidly growing market.

RESULTS OF OPERATIONS

THREE MONTHS ENDED MARCH 31, 2011 COMPARED TO THREE MONTHS ENDED MARCH 31, 2010:

During the three-month period ended March 31, 2011 (the "2011 Period") revenues were \$370,504 compared to revenues of \$545,809 during the three-month period ended March 31, 2010 (the "2010 Period"). Our revenues decreased compared to the previous year as customers continued to defer purchases of videoconferencing services, infrastructure and room systems; and delayed spending on software development services for billing integration, custom engineering, and IT consulting projects.

Cost of revenues was \$262,314 for the 2011 Period compared to \$440,436 for the 2010 Period. Cost of revenues represents primarily labor and labor-related costs in addition to overhead costs. Gross profit on these 2011 revenues amounted to \$108,190 (29% gross profit percentage) compared to \$105,373 (19% gross profit percentage) for the 2010 Period. The improved gross profit percentage resulted from our increased focus on software development and program management services in new technology areas such as operational business intelligence.

-15-

Research and development was \$45,739 for the 2011 Period compared to \$0 in the 2010 Period. The increased research and development investment resulted from our software development and testing initiatives, including CoroCall Communications Cloud Service and CoroWare Billing Integration Framework for MetraTech and FreeSwitch.

Operating expenses were \$458,514 during the 2011 Period compared to \$262,741 during the 2010 Period. Sales and marketing were higher in the 2011 Period as the Company continued to invest in sales and marketing initiatives to help increase major account sales of CoroCall and CoroWare's telepresence product sales in the coming months. The increase in General and Administrative operating expenses was primarily attributable to the inclusion of SEC legal, document preparation, and filing fees. Loss from operations was \$350,324 during the 2011 Period compared to \$157,368 in the 2010 Period.

Total other income was \$739,934 during the 2011 Period compared to \$681,288 in the 2010 Period. Other income (expense) is comprised primarily of derivative income and amortization of debt discount and deferred finance costs. Derivative income in the 2011 Period was \$899,569 compared to derivative income of \$936,711 in the 2010 Period. The embedded conversion features associated with our convertible debentures are valued based on the number of shares that are indexed to that liability. Keeping the number of shares constant, the liability associated with the embedded conversion features increases as our share price and volatility increases and, likewise, decreases when our share price and share price volatility decreases. Derivative income (expense) displays the inverse relationship. The derivative income in the 2011 Period is the result of a decreased share price (\$.0038 at December 31, 2011 versus \$0.0007 at March 31, 2011) and a relatively consistent share price volatility (140% at March 31, 2011 versus 141% at December 31, 2010). The derivative income in the 2010 Period was related to a decreased share price at the measurement dates (\$0.028 at March 31, 2010 versus \$0.08 at December 31, 2009) with volatility increasing from 488.23% at December 31, 2009 to 514.90% at March 31, 2010. Interest expense for the three month 2011 Period is \$175,097 compared to \$277,381 for the three month 2010 Period. The decrease in interest expense is a direct result of the amortization of debt discount on the convertible debt. The debt discount was amortized using the effective interest method. Under this method, the amount of amortization increased exponentially as the underlying carrying value of the amortized debt increased. The debt discount associated with the \$300,000 financing finished amortizing in the first quarter of 2010.

Net income for the 2011 Period was \$389,610 compared to net income of \$523,920 for the 2010 Period.

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2011, we had current assets of \$138,945, current liabilities of \$9,131,910, negative working capital of \$8,992,965 and an accumulated deficit of \$25,048,359. For the three months ending March 31, 2011, we had net cash flows from operating activities of (\$13,633) and net cash flows from financing activities of \$13,633.

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

However, even if we are able to raise the funds required, it is possible that we could incur unexpected costs and expenses, fail to collect significant amounts owed to us, or experience unexpected cash requirements that would force us to seek alternative financing. Furthermore, if we issue additional equity or debt securities, stockholders may

experience additional dilution or the new equity securities may have rights, preferences or privileges senior to those of existing holders of our common stock. If additional financing is not available or is not available on acceptable terms, we will have to curtail our operations.

OFF-BALANCE SHEET ARRANGEMENTS

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

CONTRACTUAL OBLIGATIONS

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

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

EFFECT OF RECENT ACCOUNTING PRONOUNCEMENTS

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company, as defined in Rule 12b-2 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), we are not required to provide the information required by this item.⁴

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

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

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

Changes in Internal Controls over Financial Reporting

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

Part II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 1A. RISK FACTORS

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

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

- (a) No material default in the payment of principal, interest, a sinking fund or purchase fund installment, or any other material default not cured within 30 days exists as of the balance sheet date.
- (b) As of the balance sheet date the company is in arrears in the payment of dividends related to its Series B preferred stock in the amount of \$15,969.
- (c) At March 31, 2011, we are in default on the remaining of the original \$2,825,000 Secured Convertible Debenture presently held by Yorkville Advisors, LLC. Yorkville currently holds \$390,628 of the first tranche, \$567,200 of the second tranche and \$103,100 of the third tranche. The remainder of the first tranche was assigned to a third party who amended the terms in March 2011 extending the maturity date to March 2013. The first tranche of this debenture was issued on July 21, 2006 in the original principal amount of \$1,250,000, the second tranche was issued on August 21, 2006 in the original principal amount of \$575,000 and the third tranche was issued on December 7, 2006 in the original principal amount of \$1,000,000. The debenture accrued interest at 10% per annum thru March 25, 2008 at which time the interest rate was increased to 14% per annum. The debenture is convertible at the option of the holder into shares of CoroWare, Inc. common stock.
- (d) As of March 31, 2011, we are in default on our Secured Convertible Debenture presently held by Yorkville Advisors, LLC in the face amount of \$600,000. The debenture accrued interest at 14% per annum and is convertible at the option of the holder into shares of CoroWare, Inc. common stock.
- (e) As of March 31, 2011, we are in default on our Secured Convertible Debenture presently held by Yorkville Advisors, LLC in the face amount of \$300,000. The debenture accrued interest at 14% per annum and is convertible at the option of the holder into shares of CoroWare, Inc. common stock.

ITEM 4. REMOVED AND RESERVED

ITEM 5. OTHER INFORMATION

ITEM 6. EXHIBITS

31 Certification of Periodic Financial Reports by Lloyd Spencer in satisfaction of Section 302 of the Sarbanes-Oxley Act of 2002

32

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

SIGNATURES

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

CoroWare, Inc.

Dated: June 7, 2011

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

