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

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

FORM 10-Q

[X] 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 Jurisdiction of Incorporation)	(I.R.S. Employer Identification No.)

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

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

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

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.

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

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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

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.

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	304,826	274,369
Accrued expenses, related parties	30,657	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.

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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.

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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 at18.99% 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 restricting or an extinguishment of debt. As such, it was accounted for as a modification and no gain or loss was recognized on the transaction. A debt discount of $236,779 was recognized for the difference in the fair value of the embedded conversion feature before and after the modification date. A new effective rate was calculated for the new debenture and the related debt discount is being amortized using the effective interest rate over the new 2 year term of the underlying loan. Amortization for the 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.

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			
Derivative income (expense)	Inception	Fair Value 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			
Derivative income (expense)	Inception	Fair Value 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