

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 July 31, 2009

OR

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 000-52815

CODA OCTOPUS GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware

34-200-8348

(State or other jurisdiction of Incorporation or organization)

(I.R.S. Employer Identification Number)

164 West, 25th Street, 6R, New York
(Address of principal executive offices)

10001
(Zip Code)

Registrant's telephone number, including area code:

(212) 924-3442

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer

Accelerated filer

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

The number of shares outstanding of issuer's common stock, \$0.001 par value as of October 2, 2009: 49,000,244.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

**CODA OCTOPUS GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEET
JULY 31, 2009 (UNAUDITED) AND OCTOBER 31, 2008**

	July 31, 2009 <u>(Unaudited)</u>	October 31, 2008 <u> </u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 574,905	\$ 3,896,149
Restricted cash, Note 2	1,394,847	1,017,007
Short-term investments, Note 4	34,000	153,000
Accounts receivable, net of allowance for doubtful accounts	1,773,922	2,589,174
Inventory	3,169,174	2,317,322
Due from related parties, Note 13	-	54,166
Unbilled receivables, Note 3	1,470,190	518,326
Other current assets, Note 5	435,397	407,080
Prepaid expenses	612,010	385,831
Total current assets	9,464,445	11,338,055
Property and equipment, net, Note 6	408,526	355,909
Deferred financing costs, net of accumulated amortization of \$268,096 in 2009 and \$181,596 in 2008, Note 12	1,331,702	1,513,297
Goodwill and other intangible assets, net, Note 7	4,255,909	3,832,023
Total assets	\$ 15,460,582	\$ 17,039,284
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable, trade	\$ 2,048,168	\$ 1,159,849
Accrued expenses and other current liabilities	2,278,205	2,347,522
Deferred revenues, Note 3	267,538	268,650
Deferred payment related to acquisitions, Note 14	217,948	-
Accrued dividends on Series A preferred stock	-	53,874
Due to related parties, Note 13	-	41,904
Loans and notes payable, short term, Note 12	13,187,381	12,358,597
Total current liabilities	17,999,240	16,230,396
Loans and notes payable, long term, Note 12	172,499	162,700
Total liabilities	18,171,739	16,393,096
Deficiency in stockholders' equity, Note 8:		
Preferred stock, \$.001 par value; 5,000,000 shares authorized, 6,287 series A issued and outstanding, as of July 31, 2009 and October 31, 2008 respectively	6	6
Common stock, \$.001 par value; 150,000,000 shares authorized, 49,000,244 and 48,853,664 shares issued and outstanding as of July 31, 2009 and October 31, 2008 respectively	49,000	48,854
Common stock subscribed	96,350	131,790
Additional paid-in capital	51,768,712	51,433,049
Accumulated other comprehensive loss	(721,033)	(1,317,696)
Accumulated deficit	(53,904,192)	(49,649,815)
Total (deficiency) surplus in stockholders' equity	(2,711,157)	646,188
Total liabilities and deficiency in stockholders' equity	\$ 15,460,582	\$ 17,039,284

See accompanying notes to these unaudited condensed consolidated financial statements.

CODA OCTOPUS GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
FOR THE THREE AND NINE MONTHS ENDED JULY 31, 2009 and 2008
(UNAUDITED)

	For the three months ended July 31, 2009	For the three months ended July 31, 2008	For the nine Months ended July 31, 2009	For the nine months ended July 31, 2008
Net revenue	\$ 3,425,030	\$ 5,008,525	\$ 10,931,583	\$ 13,232,440
Cost of revenue	<u>1,664,267</u>	<u>1,984,714</u>	<u>4,682,202</u>	<u>4,934,266</u>
Gross profit	1,760,763	3,023,811	6,249,381	8,298,174
Research and development	256,929	880,339	1,317,087	2,333,840
Selling, general and administrative expenses	1,864,880	3,311,267	7,154,059	9,170,389
Total operating expenses	<u>2,121,809</u>	<u>4,191,606</u>	<u>8,471,146</u>	<u>11,504,229</u>
Operating income (loss)	<u>(361,046)</u>	<u>(1,167,795)</u>	<u>(2,221,765)</u>	<u>(3,206,055)</u>
Other income (expense)				
Other income	21,839	47,554	53,026	96,779
Interest expense	(432,018)	(481,876)	(1,256,256)	(1,051,181)
Impairment of investment in short term investment	<u>-</u>	<u>-</u>	<u>(782,000)</u>	<u>-</u>
Total other income (expense)	<u>(410,179)</u>	<u>(434,322)</u>	<u>(1,985,230)</u>	<u>(954,402)</u>
Loss before income taxes	(771,225)	(1,602,117)	(4,206,995)	(4,160,457)
Provision for income taxes	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net loss	(771,225)	(1,602,117)	(4,206,995)	(4,160,457)
Preferred Stock Dividends:				
Series A	(15,794)	(31,819)	(47,382)	(106,843)
Net Loss Applicable to Common Shares	<u>\$ (787,019)</u>	<u>\$ (1,633,936)</u>	<u>\$ (4,254,377)</u>	<u>\$ (4,267,300)</u>
Loss per share, basic and diluted	<u>(0.02)</u>	<u>(0.03)</u>	<u>(0.09)</u>	<u>(0.09)</u>
Weighted average shares outstanding	49,000,244	48,540,133	48,967,260	48,369,873
Comprehensive loss:				
Net loss	\$ (771,225)	\$ (1,602,117)	\$ (4,206,995)	\$ (4,160,457)
Foreign currency translation adjustment	341,794	98,390	(66,337)	(23,560)
Unrealized gain (loss) on investment	<u>(34,000)</u>	<u>(280,500)</u>	<u>(34,000)</u>	<u>(663,000)</u>
Comprehensive loss	<u>\$ (463,431)</u>	<u>\$ (1,784,227)</u>	<u>\$ (4,307,332)</u>	<u>\$ (4,847,017)</u>

See accompanying notes to these unaudited condensed consolidated financial statements.

CODA OCTOPUS GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN DEFICIENCY IN STOCKHOLDERS' EQUITY
FOR THE NINE MONTHS ENDED JULY 31, 2009
(UNAUDITED)

	Preferred Stock Series A		Preferred Stock Series B		Common Stock		Common Stock Subscribed	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount	Shares	Amount					
Balance, October 31, 2008	6,287	\$ 6	-	\$ -	48,853,664	\$ 48,854	131,790	\$ 51,433,049	\$ (1,317,696)	\$ (49,649,815)	\$ 646,188
Stock issued for compensation					146,580	146	(35,440)	\$ 30,163			\$ (5,131)
Fair value of options issued for compensation								\$ 305,500			\$ 305,500
Preferred stock dividends Series A										\$ (47,382)	\$ (47,382)
Foreign currency translation adjustment									\$ (66,337)		\$ (66,337)
Realized loss on marketable securities reclassified to earnings									\$ 697,000		\$ 697,000
Unrealized loss on marketable securities									\$ (34,000)		\$ (34,000)
Net loss										\$ (4,206,995)	\$ (4,206,995)
Balance July 31, 2009	<u>6,287</u>	<u>\$ 6</u>	<u>-</u>	<u>\$ -</u>	<u>49,000,244</u>	<u>\$ 49,000</u>	<u>\$ 96,350</u>	<u>\$ 51,768,712</u>	<u>\$ (721,033)</u>	<u>\$ (53,904,192)</u>	<u>\$ (2,711,157)</u>

See accompanying notes to these unaudited condensed consolidated financial statements.

CODA OCTOPUS GROUP, INC.
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE NINE MONTHS ENDED JULY 31, 2009 and 2008
(UNAUDITED)

	<u>2009</u>	<u>2008</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (4,206,995)	\$ (4,160,457)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	477,849	453,623
Stock based compensation	300,369	865,206
Financing costs	1,150,714	395,430
Impairment of investment in marketable securities	782,000	-
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	916,998	319,886
Inventory	(816,599)	424,225
Prepaid expenses	(226,180)	(65,927)
Other receivables	(915,976)	(1,515,028)
Increase (decrease) in:		
Accounts payable and accrued expenses	1,164,039	(792,797)
Due to related parties	(41,904)	(41,945)
Net cash used in operating activities	(1,415,685)	(4,117,784)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(121,943)	(110,416)
Purchases of intangible assets	(8,715)	(180,123)
Increase in restricted cash	(377,840)	-
Acquisitions	(214,317)	(763,936)
Cash acquired from acquisitions	877	-
Net cash used in investing activities	(721,938)	(1,054,475)
CASH FLOWS FROM FINANCING ACTIVITIES:		
(Payments for) proceeds from loans, net	(1,019,822)	10,453,421
Preferred stock dividend paid	(101,256)	(127,541)
Net cash (used in) provided by financing activities	(1,121,078)	10,325,880
Effect of exchange rate changes on cash	(62,543)	(18,882)
Net (decrease) increase in cash	(3,321,244)	5,134,739
Cash and cash equivalents, beginning of period	3,896,149	916,257
Cash and cash equivalents, end of period	\$ 574,905	\$ 6,050,996
Cash paid for:		
Interest	\$ 1,125,542	\$ 376,909
Income taxes	-	-

Supplemental Disclosures:

During the nine months ended July 31, 2009, 146,580 shares of common stock were issued, 43,694 of which were subscribed for in the year ended October 31, 2008, and the other 102,886 shares were issued as payment of \$18,520 of compensation.

During the nine months ended July 31, 2008, 391,256 shares of common stock were issued as payment of \$238,476 of compensation that was earned, \$4,200 of non-cash financing costs and \$41,536 of Series A preferred stock dividends due.

Acquisition of Tactical Intelligence

Equipment, net	\$ 5,000
Customer relationships acquired	60,000
Non-compete agreements acquired	50,000
Goodwill	135,000
Deferred payments	(125,000)
Cash paid for acquisition	\$ 125,000

Acquisition of Dragon Design Ltd

Current assets acquired	\$	147,039
Equipment, net		51,336
Current liabilities assumed		(201,166)
Customer relationships acquired		29,740
Non-compete agreements acquired		29,740
Goodwill		282,533
Cash acquired		877
Deferred payments		(250,782)
Cash paid for acquisition	\$	<u>89,317</u>

See accompanying notes to these unaudited condensed consolidated financial statements.

CODA OCTOPUS GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 - SUMMARY OF ACCOUNTING POLICIES

A summary of the significant accounting policies applied in the preparation of the accompanying consolidated financial statements follows.

General

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in accordance with instructions to SEC form 10Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles 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. Accordingly, the results from operations for the nine month period ended July 31, 2009, are not necessarily indicative of the results that may be expected for the year ended October 31, 2009. The unaudited condensed financial statements should be read in conjunction with the consolidated October 31, 2008 financial statements and footnotes thereto included in the Company's 10K filed on March 18, 2009 with the Securities Exchange Commission (SEC) as amended.

Business and Basis of Presentation

Coda Octopus Group, Inc. ("we", "us", "our company" or "Coda"), a corporation formed under the laws of the State of Florida in 1992 (since re-domiciled to Delaware in 2004), is a developer of underwater technologies and equipment for imaging, mapping, defense and survey applications. We are based in New York, with research and development, sales and manufacturing facilities located in the Utah, the United Kingdom and Norway, and additional sales locations in Florida and Washington, D.C.

The unaudited condensed consolidated financial statements include the accounts of Coda and our domestic and foreign subsidiaries that are more than 50% owned and controlled. All significant intercompany transactions and balances have been eliminated in the consolidated financial statements.

Use of Estimates

The preparation of unaudited condensed consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on management's best knowledge of current events and actions that we may undertake in the future, actual results may differ from those estimates.

Revenue Recognition

We record revenue in accordance with the guidance of the SEC's *Staff Accounting Bulletin SAB No. 104* (SAB 104), which supersedes *SAB No. 101* in order to encompass Emerging Issues Task Force (*EITF*) *No. 00-21, Revenue Arrangements with Multiple Deliverables*. Our revenue is derived from sales of underwater technologies and equipment for imaging, mapping, defense and survey applications, as well as from the performance of various engineering and manufacturing contracts. Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the contract price is fixed or determinable, and collectability is reasonably assured. No right of return privileges are granted to customers after shipment.

For arrangements with multiple deliverables, we recognize product revenue by allocating the revenue to each deliverable based on the fair value of each deliverable in accordance with *EITF No. 00-21* and *SAB No. 104*, and recognize revenue for equipment upon delivery and for installation and other services as performed. *EITF No. 00-21* was effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003.

Our contracts sometimes require customer payments in advance of revenue recognition. These deposit amounts are reflected as liabilities and recognized as revenue when the Company has fulfilled its obligations under the respective contracts.

Revenues derived from our software license sales are recognized in accordance with Statement of Position (SOP) *No. 97-2*, "Software Revenue Recognition", and *SOP No. 98-9*, "Modifications of *SOP No. 97-2*, Software Revenue Recognition with Respect to Certain Transactions". For software license sales for which any services rendered are not considered essential to the functionality of the software, we recognize revenue upon delivery of the software, provided (1) there is evidence of an arrangement, (2) collection of our fee is considered probable and (3) the fee is fixed and determinable.

CODA OCTOPUS GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Foreign Currency Translation

Coda translates the foreign currency financial statements of its foreign subsidiaries in accordance with the requirements of SFAS No. 52, *Foreign Currency Translation*. Assets and liabilities are translated at exchange rates existing at the balance sheet dates, related revenue and expenses are translated at average exchange rates in effect during the period and stockholders' equity, fixed assets and long-term investments are recorded at historical exchange rates. Resulting translation adjustments are recorded as a separate component in stockholders' equity as part of accumulated other comprehensive income (loss). Foreign currency transaction gains and losses are included in the statement of income.

Income Taxes

Deferred income taxes are provided using the asset and liability method for financial reporting purposes in accordance with the provisions of SFAS No. 109, *Accounting for Income Taxes*. Under this method, deferred tax assets and liabilities are recognized for temporary differences between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, and for operating loss and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be removed or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the consolidated statements of operations in the period that includes the enactment date.

Cash and Cash Equivalents

Cash equivalents are comprised of highly liquid investments with maturity of three months or less when purchased. We maintain our cash in bank deposit accounts, which at times, may exceed insured limits. We have not experienced any losses in such accounts.

Concentrations of Credit Risk

Financial instruments and related items, which potentially subject us to concentrations of credit risk, consist primarily of cash and cash equivalents and accounts receivable. We place our cash and temporary cash investments with credit quality institutions. At times, such investments may be in excess of applicable government mandated insurance limits.

Accounts Receivable

We periodically review our trade receivables in determining our allowance for doubtful accounts. Allowance for doubtful accounts was nil for the period ended July 31, 2009 and \$74,897 for the year ended October 31, 2008.

Fair Value of Financial Instruments

SFAS No. 107, "Disclosures About Fair Value of Financial Instruments", requires disclosure of the fair value of certain financial instruments. The carrying value of cash and cash equivalents, accounts receivable, other receivables, accounts payable and short-term borrowings, as reflected in the balance sheets, approximate fair value because of the short-term maturity of these instruments. Our long-term debt has interest rates that approximate market and therefore the carrying amounts approximate their fair values.

SFAS No. 157 defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions, and risk of nonperformance. SFAS No. 157 establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. SFAS No. 157 establishes three levels of inputs that may be used to measure fair value:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets with insufficient volume or infrequent transactions (less active markets); or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 - Unobservable inputs to the valuation methodology that are significant to the measurement of fair value of assets or liabilities.

CODA OCTOPUS GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes, the level in the fair value hierarchy within which the fair value measurement is disclosed is determined based on the lowest level input that is significant to the fair value measurement.

Items recorded or measured at fair value on a recurring basis in the accompanying financial statements consisted of the following items as of July 31, 2009:

	Total	Quoted Prices in Active Markets for Identical Instruments Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Assets:				
Short term Investment	\$ 34,000	\$ 34,000		
Total	\$ 34,000	\$ 34,000	-	-
Liabilities:				
Notes Payable	\$ 13,184,357	\$ 13,184,357	-	-
Total	\$ 13,184,357	\$ 13,184,357	-	-

With the exception of assets and liabilities included within the scope of FSP FAS No. 157-2, the Company adopted the provisions of SFAS No. 157 prospectively effective as of the beginning of the year ended October 31, 2008. For financial assets and liabilities included within the scope of FSP FAS No. 157-2, the Company will be required to adopt the provisions of SFAS No. 157 prospectively as of the year beginning November 1, 2009. The adoption of SFAS No. 157 did not have a material impact on our financial position or results of operations, and the Company do not believe that the adoption of FSP FAS No. 157-2 will have a material impact on our financial position or results of operations.

The fair value of the short term investments and notes payable at July 31, 2009 was grouped as Level 1 valuation as the market price was readily available, and there has been no change to the fair value at July 31, 2009.

Debt and Equity Securities

The Company follows the provisions of Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS 115). The Company classifies debt and equity securities into one of three categories: held-to-maturity, available-for-sale or trading. These security classifications may be modified after acquisition only under certain specified conditions. Securities may be classified as held-to-maturity only if the Company has the positive intent and ability to hold them to maturity. Trading securities are defined as those bought and held principally for the purpose of selling them in the near term. All other securities must be classified as available-for-sale.

CODA OCTOPUS GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Held-to-maturity securities are measured at amortized cost in the consolidated balance sheets. Unrealized holding gains and losses are not included in earnings or in a separate component of capital. They are merely disclosed in the notes to the consolidated financial statements.

Available-for-sale securities are carried at fair value on the consolidated balance sheets. Unrealized holding gains and losses are not included in earnings but are reported as a net amount (less expected tax) in a separate component of capital until realized.

Trading securities are carried at fair value on the consolidated balance sheets. Unrealized holding gains and losses for trading securities are included in earnings.

Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses.

Inventory

Inventory is stated at the lower of cost or market using the first-in first-out method. Inventory is comprised of the following components at July 31, 2009 and October 31, 2008:

	<u>2009</u>	<u>2008</u>
Raw materials	\$ 1,500,303	\$ 1,917,566
Work in process	138,564	113,942
Finished goods	<u>1,530,306</u>	<u>285,814</u>
Total inventory	<u>\$ 3,169,174</u>	<u>\$ 2,317,322</u>

Property and Equipment

We record our equipment at historical cost. We expense maintenance and repairs as incurred. Depreciation is provided for by the straight-line method over three to four years, the estimated useful lives of the property and equipment.

Long-Lived Assets

We follow SFAS No. 144, "Accounting for Impairment of Disposal of Long-Lived Assets", which established a "primary asset" approach to determine the cash flow estimation period for a group of assets and liabilities that represents the unit of accounting for a long-lived asset to be held and used. Long-lived assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less cost to sell. No impairment loss was recognized during the period ended July 31, 2009 or the year ended October 31, 2008.

CODA OCTOPUS GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Research and Development

Research and development costs consist of expenditures for the present and future patents and technology, which cannot be capitalized. We are eligible for United Kingdom tax credits related to our qualified research and development expenditures. Tax credits are classified as a reduction of research and development expense. We recorded tax credits of \$204,081 during the period ended July 31, 2009 and nil during the year ended October 31, 2008.

Marketing

We charge the costs of marketing to expense as incurred. For the period ended July 31, 2009 marketing costs were \$459,713 and \$1,237,175 for the year ended October 31, 2008.

Intangible Assets

Intangible assets consist principally of the excess of cost over the fair value of net assets acquired (or goodwill), customer relationships, non-compete agreements and licenses. Goodwill was allocated to our reporting units based on the original purchase price allocation. Goodwill is not amortized and is evaluated for impairment annually or more often if circumstances indicate impairment may exist. Customer relationships, non-compete agreements, patents and licenses are being amortized on a straight-line basis over periods of 2 to 10 years. The Company amortizes its amortizable intangible assets using the straight-line method over their estimated period of benefit. We periodically evaluate the recoverability of intangible assets and take into account events or circumstances that warrant revised estimates of useful lives or that indicate that impairment exists.

We test for impairment at the reporting unit level as defined in SFAS No. 142, "Goodwill and Other Intangible Assets". This test is a two-step process. The first step of the goodwill impairment test, used to identify potential impairment, compares the fair value of the reporting unit with its carrying amount, including goodwill. If the fair value, which is based on future cash flows, exceeds the carrying amount, goodwill is not considered impaired. If the carrying amount exceeds the fair value, the second step must be performed to measure the amount of the impairment loss, if any. The second step compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. In the fourth quarter of each year, we evaluate goodwill on a separate reporting unit basis to assess recoverability, and impairments, if any, are recognized in earnings. An impairment loss would be recognized in an amount equal to the excess of the carrying amount of the goodwill over the implied fair value of the goodwill. SFAS No. 142 also requires that intangible assets with determinable useful lives be amortized over their respective estimated useful lives and reviewed annually for impairment in accordance with SFAS No. 144.

Stock Based Compensation

SFAS No. 123, "Accounting for Stock-Based Compensation", established and encouraged the use of the fair value based method of accounting for stock-based compensation arrangements under which compensation cost is determined using the fair value of stock-based compensation determined as of the date of the grant or the date at which the performance of the services is completed and is recognized over the periods in which the related services are rendered. The statement also permitted companies to elect to continue using the current intrinsic value accounting method specified in Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees", to account for stock-based compensation to employees. Prior to the adoption of SFAS 123(R) we elected to use the intrinsic value based method for grants to our employees and directors and have disclosed the pro forma effect of using the fair value based method to account for our stock-based compensation to employees.

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123R (revised 2004), "Share-Based Payment" ("Statement 123R") which is a revision of SFAS No. 123.

Statement 123R supersedes APB opinion No. 25 and amends SFAS No. 95, "Statement of Cash Flows". Generally, the approach in Statement 123R is similar to the approach described in Statement 123. However, Statement 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro-forma disclosure is no longer an alternative. This statement does not change the accounting guidance for share based payment transactions with parties other than employees provided in SFAS No. 123(R). This statement does not address the accounting for employee share ownership plans, which are subject to AICPA Statement of Position 93-6, "Employers' Accounting for Employee Stock Ownership Plans." On April 14, 2005, the SEC amended the effective date of the provisions of this statement. The effect of this amendment by the SEC is that the Company had to comply with Statement 123R and use the Fair Value based method of accounting no later than the first quarter of 2006. We implemented SFAS No. 123(R) on January 1, 2006 using the modified prospective method. The fair value of each option grant issued after January 1, 2006 will be determined as of grant date, utilizing the Black-Scholes option pricing model. The amortization of each option grant will be over the remainder of the vesting period of each option grant. We did not have any unvested amounts of stock based compensation grants issued and outstanding at the date of implementation.

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We use the fair value method for equity instruments granted to non-employees and use the Black-Scholes model for measuring the fair value. The stock based fair value compensation is determined as of the date of the grant or the date at which the performance of the services is completed (measurement date) and is recognized over the periods in which the related services are rendered.

Comprehensive Income

SFAS No. 130, "Reporting Comprehensive Income", establishes standards for reporting and displaying of comprehensive income, its components and accumulated balances. Comprehensive income is defined to include all changes in equity except those resulting from investments by owners and distributions to owners. Among other disclosures, SFAS 130 requires that all items that are required to be recognized under current accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. Comprehensive income includes gains and losses on foreign currency translation adjustments and is included as a component of stockholders' equity.

Deferred Financing Costs

Deferred financing costs primarily include debt issuance costs incurred by the Company in connection with the issuance of convertible debt in February 2008 (see Note 12). Amortization is provided on a straight-line basis over the terms of the respective debt instruments to which the costs relate and is included in interest expense. Deferred financing cost expense was \$181,595 and \$181,596 in the period ended July 31, 2009 and the year ended October 31, 2008, respectively.

Loss Per Share

We use SFAS No. 128, "Earnings per Share" for calculating the basic and diluted loss per share. We compute basic loss per share by dividing net loss and net loss attributable to common shareholders by the weighted average number of common shares outstanding. Diluted loss per share is computed similar to basic loss per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential shares had been issued and if the additional shares were dilutive. Common equivalent shares are excluded from the computation of net loss per share if their effect is anti-dilutive.

Per share basic and diluted net loss amounted to \$0.09 and \$0.09 for the periods ended July 31, 2009 and 2008, respectively. For the periods ended July 31, 2009 and 2008, 50,571,559 and 48,896,559 potential shares, respectively, were excluded from the shares used to calculate diluted earnings per share as their inclusion would reduce net loss per share.

New Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115" ("SFAS No. 159"). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Most of the provisions of SFAS No. 159 apply only to entities that elect the fair value option. However, the amendment to SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities" applies to all entities with available-for-sale and trading securities. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provision of SFAS No. 157, "Fair Value Measurements". The adoption of SFAS No. 159 is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations" ("SFAS No. 141(R)"), which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in an acquiree, including the recognition and measurement of goodwill acquired in a business combination. SFAS No. 141(R) is effective as of the beginning of the first fiscal year beginning on or after December 15, 2008. The company has adopted SFAS No. 141(R) for its acquisition in the current quarter.

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In December 2007, the FASB issued SFAS No. 160, "Non-controlling Interest in Consolidated Financial Statements, an amendment of ARB No. 51" ("SFAS No. 160"), which will change the accounting and reporting for minority interests, which will be re-characterized as non-controlling interests and classified as a component of equity within the consolidated balance sheets. SFAS No. 160 is effective as of the beginning of the first fiscal year beginning on or after December 15, 2008. Earlier adoption is prohibited and the Company is currently evaluating the effect, if any that the adoption will have on its consolidated financial position, results of operations or cash flows.

In June 2007, the FASB ratified the consensus in EITF Issue No. 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services to be Used in Future Research and Development Activities" (EITF 07-3), which requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development (R&D) activities be deferred and amortized over the period that the goods are delivered or the related services are performed, subject to an assessment of recoverability. EITF 07-3 will be effective for fiscal years beginning after December 15, 2007. The Company does not expect that the adoption of EITF 07-3 will have a material impact on its consolidated financial position, results of operations or cash flows.

In December 2007, the FASB ratified the consensus in EITF Issue No. 07-1, "Accounting for Collaborative Arrangements" (EITF 07-1). EITF 07-1 defines collaborative arrangements and requires collaborators to present the result of activities for which they act as the principal on a gross basis and report any payments received from (made to) the other collaborators based on other applicable authoritative accounting literature, and in the absence of other applicable authoritative literature, on a reasonable, rational and consistent accounting policy is to be elected. EITF 07-1 also provides for disclosures regarding the nature and purpose of the arrangement, the entity's rights and obligations, the accounting policy for the arrangement and the income statement classification and amounts arising from the agreement. EITF 07-1 will be effective for fiscal years beginning after December 15, 2008, which will be the Company's fiscal year 2010, and will be applied as a change in accounting principle retrospectively for all collaborative arrangements existing as of the effective date. The Company has not yet evaluated the potential impact of adopting EITF 07-1 on its consolidated financial position, results of operations or cash flows.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an amendment to FASB Statement No. 133" ("SFAS No. 161"). SFAS No. 161 is intended to improve financial standards for derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. Entities are required to provide enhanced disclosures about: (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations; and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years beginning after November 15, 2008, with early adoption encouraged. The Company is currently evaluating the impact of SFAS No. 161, if any, will have on its consolidated financial position, results of operations or cash flows.

In April 2008, the FASB issued FSP No. SFAS No. 142-3, "Determination of the Useful Life of Intangible Assets". This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, "Goodwill and Other Intangible Assets". The Company is required to adopt FSP 142-3 on September 1, 2009, earlier adoption is prohibited. The guidance in FSP 142-3 for determining the useful life of a recognized intangible asset shall be applied prospectively to intangible assets acquired after adoption, and the disclosure requirements shall be applied prospectively to all intangible assets recognized as of, and subsequent to, adoption. The Company is currently evaluating the impact of FSP 142-3 on its consolidated financial position, results of operations or cash flows.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS No. 162"). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (the GAAP hierarchy). SFAS No. 162 will become effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." The Company does not expect the adoption of SFAS No. 162 to have a material effect on its consolidated financial position, results of operations or cash flows.

In May 2008, the FASB issued FSP Accounting Principles Board ("APB") 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)" ("FSP APB 14-1"). FSP APB 14-1 requires the issuer of certain convertible debt instruments that may be settled in cash (or other assets) on conversion to separately account for the liability (debt) and equity (conversion option) components of the instrument in a manner that reflects the issuer's non-convertible debt borrowing rate. FSP APB 14-1 is effective for fiscal years beginning after December 15, 2008 on a retroactive basis. The Company is currently evaluating the potential impact, if any, of the adoption of FSP APB 14-1 on its consolidated financial position, results of operations or cash flows.

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In June 2008, the FASB issued FSP Emerging Issues Task Force (EITF) No. 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities." Under the FSP, unvested share-based payment awards that contain rights to receive non-forfeitable dividends (whether paid or unpaid) are participating securities, and should be included in the two-class method of computing EPS. The FSP is effective for fiscal years beginning after December 15, 2008, and interim periods within those years. The Company does not expect the adoption of FSP EITF No. 03-6-1 to have a material effect on its consolidated financial position, results of operations or cash flows.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA, and the SEC did not, or are not believed by management to, have a material impact on the Company's present or future condensed consolidated financial statements.

In June 2008, the FASB issued Emerging Issues Task Force No. 07-5 (EITF 07-5), *Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock*. EITF 07-5 requires entities to evaluate whether an equity-linked financial instrument (or embedded feature) is indexed to its own stock by assessing the instrument's contingent exercise provisions and settlement provisions. Instruments not indexed to their own stock fail to meet the scope exception of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, paragraph 11(a), and should be classified as a liability and marked-to-market. The statement is effective for fiscal years beginning after December 15, 2008 and is to be applied to outstanding instruments upon adoption with the cumulative effect of the change in accounting principle recognized as an adjustment to the opening balance of retained earnings. The Company is assessing the impact of this pronouncement on its financial statements.

Liquidity

As of July 31, 2009 we have cash and cash equivalents of \$574,905, a working capital deficit of \$8,534,795 and a deficiency in stockholders' equity of \$2,711,157. For the period ended July 31, 2009, we had a net loss of \$4,206,995 and negative cash flow from operations of \$1,415,685. We also have an accumulated deficit of \$53,904,192 at July 31, 2009.

NOTE 2 – RESTRICTED CASH

Under terms of the Company's secured convertible debenture dated February 26, 2008, we maintained a \$1,000,000 interest-bearing deposit in a restricted bank account until such time as advances under an accounts receivable factoring agreement were repaid in full and the agreement and related liens were terminated. As of October 31, 2008, the Company had \$1,017,007 in the restricted cash account, which was released to the Company in December 2008 after the factoring agreement was terminated and settled in full in October 2008 and the debenture holders perfected their security in December 2008.

On March 16, 2009, the Company and the holder of the secured convertible debenture ("the Noteholder") entered into a Cash Control Framework Agreement, pursuant to which it is assumed that, subject to the Company being fully compliant with the terms of this agreement and those set out in the Transaction Documents entered into between the Company and the Noteholder on February 21, 2008, no adverse actions will be taken by the Noteholder. The agreement provides, among other things, for the placement of approximately \$2.15 million into a segregated cash account. Under the terms of the agreement, we may request the release of funds from the account from time to time for working capital purposes, subject to the Noteholder's consent and agreed upon terms and conditions. Under the terms of the agreement, we must also adhere to a strict cost cutting program which involves reducing our SG&A, R&D and capital expenditure by an annualized \$3.35 million. We believe that the terms of this agreement may provide us with sufficient liquidity to operate for fiscal 2009.

At July 31, 2009 we have received net advances from this facility of \$755,153.

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NOTE 3 - CONTRACTS IN PROGRESS

Costs and estimated earnings in excess of billings on uncompleted contracts represent accumulated project expenses and fees which have not been invoiced to customers as of the date of the balance sheet. These amounts are stated on the balance sheet as Unbilled Receivables of \$1,470,190 and \$518,326 as of July 31, 2009 and October 31, 2008 respectively.

Billings in excess of cost and estimated earnings on uncompleted contracts represent project invoices billed to customers that have not been earned as of the date of the balance sheet. These amounts are stated on the balance sheet as Deferred Revenue of \$31,954 and \$57,513 as of July 31, 2009 and October 31, 2008 respectively.

Revenue received as part of sales of equipment includes a provision for warranty and is treated as deferred revenue, along with extended warranty sales, with these amounts amortized over 12 months from the date of sale. These amounts are stated on the balance sheet as Deferred Revenue of \$235,583 and \$211,137 as of July 31, 2009 and October 31, 2008 respectively.

NOTE 4 - INVESTMENTS

During the year ended October 31, 2007, the Company received marketable securities in settlement of \$533,147 loan and \$316,853 of accounts receivable. As of October 31, 2008, the Company had an investment of \$153,000 that was considered available-for-sale for financial reporting purposes which included an unrealized loss of \$697,000 included in the determination of comprehensive loss. As of April 30, 2009, this investment had a value of \$68,000, with an unrealized loss of \$782,000. This unrealized loss has, until now been included in the determination of comprehensive loss, but, during the period ended July 31, 2009, we have determined that this investment in marketable securities is impaired because we believe that the fair market value of the investment has permanently declined. Accordingly, we have written off the \$782,000 during the period ended July 31, 2009. The remaining fair value of this investment is \$34,000 as of July 31, 2009.

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NOTE 5 - OTHER CURRENT ASSETS

Other current assets on the balance sheet total \$435,397 and \$407,080 at July 31, 2009 and October 31, 2008 respectively. These totals comprise the following:

	<u>2009</u>	<u>2008</u>
Deposits	\$ 95,402	\$ 110,548
Value added tax (VAT)	19,307	262,090
Other receivable	<u>320,689</u>	<u>34,442</u>
Total	<u>\$ 435,397</u>	<u>\$ 407,080</u>

NOTE 6 - FIXED ASSETS

Property and equipment at July 31, 2009 and October 31, 2008 is summarized as follows:

	<u>2009</u>	<u>2008</u>
Machinery and equipment	\$ 1,253,649	\$ 1,076,950
Accumulated depreciation	<u>(845,123)</u>	<u>(721,041)</u>
Net property and equipment assets	<u>\$ 408,526</u>	<u>\$ 355,909</u>

Depreciation expense recorded in the statement of operations for the period ended July 31, 2009 and year ended October 31, 2008 is \$124,412 and \$176,147, respectively.

NOTE 7 - INTANGIBLE ASSETS AND GOODWILL

The Company has adopted SFAS No. 142, Goodwill and Other Intangible Assets, whereby the Company periodically tests its intangible assets for impairment. On an annual basis, and when there is reason to suspect that their values have been diminished or impaired, these assets are tested for impairment, and write-downs will be included in results from operations.

The identifiable intangible assets acquired and their carrying value at July 31, 2009 and October 31, 2008 is:

	<u>2009</u>	<u>2008</u>
Customer relationships (weighted average life of 9.2 years)	\$ 784,242	\$ 694,503
Non-compete agreements (weighted average life of 2.8 years)	278,650	198,911
Patents (weighted average life of 10 years)	72,412	63,695
Licenses (weighted average life of 2 years)	<u>100,000</u>	<u>100,000</u>
Total amortized identifiable intangible assets - gross carrying value	1,235,304	1,057,109
Less accumulated amortization	<u>(496,503)</u>	<u>(324,661)</u>
Net	<u>738,801</u>	<u>732,448</u>
Residual value	<u>\$ 738,801</u>	<u>\$ 732,448</u>

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Our acquisition of Dragon Design Ltd (“Dragon”) in December 2008 resulted in the valuation of Dragon’s customer relationships and covenants not to compete as intangible assets (see Note 14), which have an estimated useful life of 3 years each, and as such are being amortized on a straight-line basis over that period. In addition, we recognized goodwill of \$282,533 that represents the excess of the purchase price we paid over the fair value of Dragon’s net tangible and intangible assets we acquired.

Our acquisition of the assets of Tactical Intelligence, LLC (“Tactical”) In November 2008 resulted in the valuation of Tactical’s customer relationships and covenants not to compete as intangible assets (see Note 14), which have an estimated useful life of 3 years each, and as such are being amortized monthly over that period. In addition, we recognized goodwill of \$135,000 that represents the excess of the purchase price we paid over the fair value of Tactical’s net tangible and intangible assets acquired.

Estimated annual amortization expense as of July 31, 2009 is as follows:

2009	\$ 50,967
2010	143,592
2011	131,537
2012	76,696
2013 and thereafter	<u>336,008</u>
Total	<u>\$ 738,801</u>

Amortization of patents, customer relationships, non-compete agreements and licenses included as a charge to income amounted to \$171,842 and \$189,621 for the period ended July 31, 2009 and year ended October 31, 2008, respectively. Goodwill is not being amortized.

As a result of the acquisitions of Martech, Colmek, Dragon and Tactical, the Company has goodwill in the amount of \$3,517,108 as of July 31, 2009 and \$3,099,575 as of October 31, 2008. The changes in the carrying amount of goodwill for the period ended July 31, 2009 and year ended October 31, 2008 are recorded below.

	<u>2009</u>	<u>2008</u>
Beginning goodwill balance at November 1:		
CodaOctopus Colmek, Inc.	\$ 2,038,699	\$ 2,038,669
CodaOctopus Martech Ltd	998,591	998,591
CodaOctopus Products Ltd	62,315	62,315
Goodwill recorded upon acquisition:		
CodaOctopus Tactical Intelligence, Inc.	135,000	-
Dragon Design Ltd	<u>282,533</u>	<u>-</u>
Balance at July 31, 2009 and October 31, 2008	<u>\$ 3,517,108</u>	<u>\$ 3,099,575</u>

Considerable management judgment is necessary to estimate fair value. We enlist the assistance of an independent valuation consultant to determine the values of our intangible assets and goodwill, both at the dates of acquisition and at specific dates annually. Based on various market factors and projections used by management, actual results could vary significantly from managements' estimates.

NOTE 8 - CAPITAL STOCK

The Company is authorized to issue 150,000,000 shares of common stock with a par value of \$.001 per share. As of July 31, 2009 and October 31, 2008, the Company has issued and outstanding 49,000,244 shares and 48,853,664 shares of common stock, respectively. The Company is also authorized to issue 5,000,000 shares of preferred stock with a par value of \$.001 per share. We have designated 50,000 preferred shares as Series A preferred stock and 50,000 preferred shares as Series B preferred stock. The remaining 4,900,000 shares of preferred stock is undesignated. There were 6,287 Series A preferred shares outstanding at July 31, 2009 and October 31, 2008 respectively, and nil Series B preferred shares outstanding at the same dates.

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Series A Preferred Stock

We designated 50,000 shares of our preferred stock, par value \$.001, as Series A Preferred Stock. The Series A Preferred Stock ranks senior to all classes of common and preferred stock and has no liquidation preference above par. The Series A Preferred Stock is sold as units of \$100 (or £100 where stock has been sold to investors in British Pounds) and has a dividend rate of 12% per year, ie. \$12 per \$100 unit, paid every six months, in May and November each year. The Series A Preferred Stock and accrued dividends is convertible at the option of the holder into shares of our common stock at a conversion price of \$1.00 per share, and at the option of the Company when the stock price reaches or exceeds \$3.00.

During the year ended October 31, 2008, we issued 200 shares of Series A Preferred Stock, which were subscribed for in March 2007 and converted 320 shares of Series A Preferred Stock into 32,000 shares of common stock. The total of Series A preferred stock outstanding is 6,287 shares at October 31, 2008 and July 31, 2009, convertible into 1,013,670 shares of common stock.

Series B Preferred Stock

We designated 50,000 shares of our preferred stock, par value \$.001, as Series B Preferred Stock. The Series B Preferred Stock ranks junior to our issued and outstanding Series A preferred Stock and senior to all classes of common stock. The Series B Preferred Stock has a dividend rate of 8% per year. The Series B Preferred Stock and accrued dividends are convertible at the option of the holder into shares of our common stock at a conversion price of \$1.00 per share. As of October 31, 2008 and July 31, 2009, we have no shares of Series B Preferred Stock outstanding.

Common Stock

During the period ending July 31, 2009 we issued 146,580 shares of common stock, valued at \$30,310, to employees, directors and consultants for services, of which \$11,790 was subscribed for during the year ending October 31, 2008, leaving a charge for compensation in the period ending July 31, 2009 of \$18,520.

During the year ended October 31, 2008 we issued 452,937 shares of common stock, valued at \$263,476, to employees, directors and consultants for services. We also issued 38,319 shares as dividends on Series A Preferred Stock, which had accrued over the period August 2006 to April 2008, valued at \$41,537. A further 60,000 shares of common stock were issued to an investor, which were subscribed for during the year to October 31, 2007, plus 4,200 shares for financing, and 56,640 shares to an investor on conversion of 320 shares of Series A Preferred stock.

Other Equity Transactions

During the period ended July 31, 2009, we did not issue any common share purchase options. However, options issued in earlier periods vested, resulting in a charge of \$305,501 in this period. There were also 210,000 options cancelled connected with staff departures, of which 95,000 were exercisable.

During the year ended October 31, 2008, we issued in the aggregate 1,870,000 common share purchase options to employees and consultants, with exercise prices of \$1.30 to \$1.50. The initial fair value of the options was \$872,170 using the Black-Scholes method at the date of grant of the options based on the following assumptions: (1) risk free interest rate of 3.43%-5.25%; (2) dividend yield of 0%; (3) volatility factor of the expected market price of our common stock of 222% - 246%; and (4) an expected life of the options of 2 years. The fair value of the options has been expensed in this period. In accordance with EITF 96-18, the fair value of consultant vesting options will be recomputed at each reporting period and any increase will be charged to expense. Due to staff departures, 50,000 options were cancelled, all of which had exercise prices of \$1.70. During the year ended October 31, 2008, \$257,547 was charged to expense.

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NOTE 9 - WARRANTS AND STOCK OPTIONS

Transactions involving stock options and warrants issued are summarized as follows:

Warrants	Nine months ended July 31, 2009		Year ended October 31, 2008	
	Number	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
Outstanding at beginning of the period	32,583,418	\$ 1.42	31,983,418	\$ 1.42
Granted during the period	-	-	600,000	1.50
Terminated during the period	-	-	-	-
Outstanding at the end of the period	<u>32,583,418</u>	<u>\$ 1.42</u>	<u>32,583,418</u>	<u>\$ 1.42</u>
Exercisable at the end of the period	<u>32,583,418</u>	<u>\$ 1.42</u>	<u>32,583,418</u>	<u>\$ 1.42</u>

The number and weighted average exercise prices of warrants outstanding as of July 31, 2009 are as follows:

Range of Exercise Prices	Number Outstanding	Weighted Average Contractual Life (Yrs)	Total Exercisable
0.50	750,000	1.75	750,000
0.58	400,000	1.67	400,000
1.00	2,750,000	2.60	2,750,000
1.30	14,341,709	2.42	14,341,709
1.50	-	-	-
1.70	14,341,709	2.42	14,341,709
1.80	-	-	-
Totals	<u>32,583,418</u>	<u>2.47</u>	<u>32,583,418</u>

Stock Options	Nine months ended July 31, 2009		Year ended October 31, 2008	
	Number	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
Outstanding at beginning of the period	5,755,900	\$ 1.18	4,535,900	\$ 1.16
Granted during the period	-	-	1,270,000	1.30
Terminated during the period	(210,000)	1.32	(50,000)	1.70
Outstanding at the end of the period	<u>5,545,900</u>	<u>\$ 1.18</u>	<u>5,755,900</u>	<u>\$ 1.18</u>
Exercisable at the end of the period	<u>4,889,100</u>	<u>\$ 1.16</u>	<u>4,578,000</u>	<u>\$ 1.14</u>

The number and weighted average exercise prices of stock purchase options outstanding as of July 31, 2009 are as follows:

Range of Exercise Prices	Number Outstanding	Weighted Average Contractual Life (Yrs)	Total Exercisable
0.50	-	-	-
0.58	-	-	-
1.00	3,045,900	1.12	3,045,900
1.30	1,705,000	3.57	1,048,200
1.50	425,000	2.45	425,000
1.70	310,000	2.92	310,000
1.80	60,000	3.15	60,000
Totals	<u>5,545,900</u>	<u>2.10</u>	<u>4,889,100</u>

NOTE 10 - INCOME TAXES

The Company has adopted Financial Accounting Standard No. 109 which requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statement or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between financial statements and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Temporary differences between taxable income reported for

financial reporting purposes and income tax purposes are insignificant.

For income tax reporting purposes, the Company's aggregate US unused net operating losses approximate \$45,400,000 which expire through 2029, subject to limitations of Section 382 of the Internal Revenue Code, as amended. The deferred tax asset related to the carry forward is approximately \$15,436,000. The Company has provided a valuation reserve against the full amount of the net operating loss benefit, because in the opinion of management based upon the earning history of the Company, it is more likely than not that the benefits will not be realized.

For income tax reporting purposes, the Company's aggregate UK unused net operating losses approximate \$7,344,000, with no expiration. The deferred tax asset related to the carry-forward is approximately \$2,277,000. The Company has provided a valuation reserve against the full amount of the net operating loss benefit, because in the opinion of management based upon the earning history of the Company, it is more likely than not that the benefits will not be realized.

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Income tax expense for 2008 represents income taxes on our Norwegian subsidiary.

Components of deferred tax assets as of July 31, 2009 and October 31, 2008 are as follows:

Non-Current	2009	2008
Net Operating Loss Carry Forward	\$ 17,713,000	\$ 16,485,000
Valuation Allowance	(17,713,000)	(16,485,000)
Net Deferred Tax Asset	<u>\$ -</u>	<u>\$ -</u>

NOTE 11 - CONTINGENCIES AND COMMITMENTS

Litigation

The Company is currently engaged in a lawsuit involving the former Chief Executive Officer of its subsidiary, Coda Octopus Colmek, Inc. The former CEO claims breach of his employment contract, tortious interference with his contract, termination in violation of public policy and failure to pay wages when due. He filed a complaint on November 10, 2008 and an amended complaint on December 10, 2008. We answered the amended complaint on December 22, 2008 denying the allegations, raising affirmative defenses and intend to defend ourselves vigorously. We believe that the final disposition should not have a material adverse effect on our financial position or results of operations.

We may become subject to other legal proceedings and claims, which arise in the ordinary course of our business. Although occasional adverse decisions or settlements may occur, we believe that the final disposition of any matters should not have a material adverse effect on our financial position or results of operations.

Factoring Agreement

Until October 31, 2008, we factored certain of our receivables pursuant to a number of factoring agreements with Faunus Group International ("FGI"). Advances received pursuant to the agreement are secured by our accounts receivable and other assets of the Company. An initial factoring agreement was entered into on August 17, 2005 between FGI and Coda Octopus Group, Inc., for a maximum borrowing in the US of up to \$1 million. Subsequent agreements were added in November 2006 covering our UK businesses, Martech Systems Ltd and Coda Octopus Products Ltd. Under the arrangement, FGI typically advanced to the Company 80% of the total amount of accounts receivable factored. FGI retained 20% of the outstanding factored accounts receivable as a reserve, which it holds until the customer pays the factored invoice to FGI. The cost of funds for the accounts receivable portion of the borrowings with FGI was 1.85% for the initial 30 day credit period, up to a maximum of 45 days; thereafter, an additional fee of 0.5% was charged for each 10 day period.

Over the course of the year ended October 31, 2008, we factored invoices totaling \$7,545,200 in receivables and we received \$5,828,550 in proceeds from FGI. As of October 31, 2008 all FGI agreements were terminated and advances repaid in full.

On February 20, 2008, FGI, RBS entered into an inter-creditor agreement with the Company, regulating the priority of each creditor's debts.

Operating Leases

We occupy our various office and warehouse facilities pursuant to both term and month-to-month leases. Our term leases expire at various times through September 2013. Future minimum lease obligations are approximately \$1,716,013, with the minimum future rentals due under these leases as of July 31, 2009 as follows:

2009	\$ 150,615
2010	492,973
2011	468,810
2012	258,389
2013 and thereafter	<u>345,224</u>
Total	<u><u>\$ 1,716,013</u></u>

Concentrations

We had no concentrations of purchases of over 5% during either of the period ended July 31, 2009 and year ended October 31, 2008. We had a sales concentration of over 5% for the period ended July 31, 2009 and for the year ended October 31, 2008 due to a sale to a customer for \$1,178,783 and \$1,557,130 respectively.

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NOTE 12 - NOTES AND LOANS PAYABLE

A summary of notes payable at July 31, 2009 and October 31, 2008 is as follows:

	July 31, 2009	October 31, 2008
The Company has a secured convertible debenture for \$12M with a life of 7 years from February 26, 2008, maturing at 130% of face value, and with interest payable every six months, starting in February 2009, at a rate of 8.5%; During the term, the debentures are convertible into our common stock at the option of the Noteholders at a conversion price of \$1.05. We may also force the conversion of these Notes into our common stock after two years in the event that we obtain a listing on a national exchange and our stock price closes on 40 consecutive trading days at or above \$2.50 between the second and third anniversaries of this agreement; \$2.90 between the third and fourth anniversaries of this agreement; and \$3.50 after the fourth anniversary of this agreement or where the daily volume weighted average price of our stock as quoted on OTCBB or any other US National Exchange on which our securities are then listed has, for at least 40 consecutive trading days closed at the agreed price. The Company has failed to comply with certain covenants contained in the debenture agreement.	\$ 13,184,357	\$ 12,348,493
The Company, through its UK subsidiary Coda Octopus Products Ltd has a 7 year unsecured loan note for £100,000; interest rate of 12% annually; repayable at borrower's instigation or convertible into common stock when the share price reaches \$3.	165,241	162,700
The Company through its US subsidiary Coda Octopus Colmek, Inc., has an unsecured loan note payable to a director and former officer of the Company, which is being repaid in the short term.	-	10,104
The Company through its UK subsidiary, Dragon Design Ltd, has an outstanding loan note payable for £14,000 over 36 months, commencing in November 2007, with monthly payments of £454.42 and an annual interest rate of 14.5%. By the end of July 2009, 17 payments remained on this note.	10,282	-
The Company through its UK subsidiary, Dragon Design Ltd, has an unsecured revolving line of credit with their bank for £40,000, which is repayable on demand. The amount outstanding on this line of credit was reduced to zero in February 2009.	-	-
Total	\$ 13,359,880	\$ 12,521,297
Less: current portion	<u>13,187,381</u>	<u>12,358,597</u>
Total long-term portion	\$ 172,499	\$ 162,700

In connection with the secured convertible debenture noted above and the Cash Control Framework Agreement (see below), we carry \$1,331,702 deferred financing costs as an asset on the consolidated balance sheet at July 31, 2009, which represents \$1,694,893 in financing closing costs we incurred, net of \$363,191 in amortization expense at July 31, 2009 and \$181,596 in amortization expense at October 31, 2008. We amortize deferred financing costs over the life of the financing facility using the straight line method.

On March 16, 2009, the Company and the holder of the secured convertible debenture ("the Noteholder") entered into a Cash Control Framework Agreement, pursuant to which it is assumed that, subject to the Company being fully compliant with the terms of this agreement and those set out in the Transaction Documents entered into between the Company and the Noteholder on February 21, 2008, no adverse actions will be taken by the Noteholder. The agreement provides, among other things, for the placement of approximately \$2.15 million into a segregated cash account. Under the terms of the agreement, we may request the release of funds from the account from time to time for working capital purposes, subject to the Noteholder's consent and agreed upon terms and conditions. Under the terms of the agreement, we must also adhere to a strict cost cutting program which involves reducing our SG&A, R&D and capital expenditure by an annualized \$3.35 million. We believe that the terms of this agreement may provide us with sufficient liquidity to operate for fiscal 2009.

NOTE 13 - RELATED PARTY TRANSACTIONS

We have been indebted to various related parties for advances for payments of operating expenses and dividends. These related parties include our biggest shareholder and other entities controlled by this shareholder. Advances are non interest bearing and are due on demand. At the end of the period ending July 31, 2009, nil was due to related parties, compared with \$41,904 for the year ending October 31, 2008.

We are also owed by related parties a sum of nil at July 31, 2009 compared to \$54,166 at October 31, 2008.

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NOTE 14 - ACQUISITIONS

Acquisition of Tactical Intelligence

In November 2008, the Company formed a new subsidiary called Coda Octopus Tactical Intelligence, Inc. (“Tactical”) to facilitate our entry into the counter-terrorism and anti-piracy training markets, which we believe are integral to our efforts to help major customers deploy real time 3D sonar systems in hot spots around the world. On November 10, 2008, Tactical acquired the assets of Tactical Intelligence International, LLC and Tactical Executive Services, LLC, which consisted of some plant and machinery, valued at \$5,000, customer relationships, valued at \$60,000, non-compete agreements, valued at \$50,000, and goodwill, valued at \$135,000. The purchase price consisted of an initial cash outlay of \$125,000, a convertible promissory note in the amount of \$125,000 due on November 10, 2009, and 50,000 options to acquire common shares of Coda Octopus Group, Inc., which are due to be issued in June 2009. As part of the transaction we acquired the services of two specialists in the field of real world security training for domestic and international military units and government agencies to spearhead this drive. These individuals have designed or led more than 50 such training programs throughout the world since September 11, 2001, using up to 100 freelance specialists on a contract basis. The expertise of this part of the Group will be used to leverage our Echoscope and UIS capabilities in sales and training.

The acquisition of Tactical was accounted for using the purchase method in accordance with SFAS 141. The results of operations for Tactical have been included in the Consolidated Statements of Operations since the date of acquisition. In accordance with SFAS No. 141, the total purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. The estimate of fair value of the assets acquired was based on management’s estimates. The total purchase price was allocated to the assets and liabilities acquired as follows:

Equipment, net	\$ 5,000
Customer relationships acquired	60,000
Non-compete agreements acquired	50,000
Goodwill	135,000
Total purchase price	\$ 250,000

The intangible assets acquired consisted of customer relationships and non-compete agreements, which have an estimated useful life of 3 years each and as such will be amortized monthly over those periods. Goodwill of \$135,000 represented the excess of the purchase price over the fair value of the net tangible and intangible assets acquired.

Acquisition of Dragon Design Ltd

In December 2008, the Company acquired the assets of Dragon Design Ltd (“Dragon”), an electronics manufacturing and design business based in Weymouth, UK, and situated next to its Martech subsidiary. Management believes the companies have complementary skills and capabilities that can enhance revenues and opportunities for both companies. The purchase price for the assets consisted of an initial cash outlay of £56,250 (\$83,000) and a further £56,250 in deferred consideration, payable on the first anniversary of closing. The terms of the acquisition also included a potential earn out payment of £112,500, which is dependent on Dragon meeting future agreed performance criteria, that has also been accrued on the acquisition date.

The acquisition of Dragon was accounted for using the purchase method in accordance with SFAS 141(R). The results of operations for Dragon have been included in the Consolidated Statements of Operations since the date of acquisition. In accordance with SFAS No. 141(R), the total purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. The estimate of fair value of the assets acquired was based on management’s estimates. The total purchase price was allocated to the assets and liabilities acquired as follows:

Current assets acquired	\$ 147,039
Equipment, net	51,336
Current liabilities assumed	(201,166)
Customer relationships acquired	29,740
Non-compete agreements acquired	29,740
Goodwill	282,533
Cash acquired	877
Total purchase price	\$ 340,099

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The intangible assets acquired, comprising customer relationships and non-compete agreements, have an estimated useful life of 3 years each and as such will be amortized monthly over those periods. Goodwill of \$282,533 represented the excess of the purchase price over the fair value of the net tangible and intangible assets acquired.

The following unaudited pro forma results of operations for the period ended July 31, 2009 assume that the acquisition of Dragon occurred on November 1, 2008. These unaudited pro forma results are not necessarily indicative of the actual results of operations that would have been achieved nor are they necessarily indicative of future results of operations.

	2009
Revenue	\$ 11,063,282
Net loss	(4,262,059)
Loss per common share	\$ (0.09)

NOTE 15 - SEGMENT INFORMATION

Due to the nature of our businesses, we are operating in two reportable segments, which are managed separately based upon fundamental differences in their operations. Martech, Dragon, Colmek, Tactical and Innalogic operate as contractors, and the balance of our operations is comprised of product sales.

Segment operating income is total segment revenue reduced by operating expenses identifiable with the business segment. Corporate includes general corporate administrative costs.

The Company evaluates performance and allocates resources based upon operating income. The accounting policies of the reportable segments are the same as those described in the summary of accounting policies.

There are inter-segment sales between our engineering contracting businesses and our products businesses, which have been removed from the information shown below.

The following table summarizes asset and operating balances by reportable segment.

	July 31, 2009			October 31, 2008		
	Contracting	Products	Corporate	Contracting	Products	Corporate
Current assets, excl. interco.	\$ 4,532,515	\$ 2,399,373	\$ 2,532,557	\$ 3,370,812	\$ 4,181,440	\$ 4,137,564
Property and equipment, net	211,825	113,578	83,122	163,238	141,189	51,483
Deferred financing costs	-	-	1,331,702	-	-	1,513,297
Goodwill	3,454,793	62,315	-	3,037,260	62,315	-
Other intangible assets	691,154	-	47,647	689,760	-	42,688
Total assets	8,890,287	2,575,266	3,995,028	7,261,070	4,384,945	5,745,032
Current liabilities, excl. interco.	2,475,517	1,216,137	14,307,585	1,470,179	900,709	13,859,509
Long term liabilities	7,258	165,241	-	-	162,700	-
Total liabilities	2,482,775	1,381,378	14,307,585	1,470,179	1,063,409	13,859,509
Capital expenditure	251,668	20,499	108,491	33,381	58,064	18,931
	Nine months ended July 31, 2009			Nine months ended July 31, 2008		
Revenues	7,360,565	3,571,018	-	6,400,429	6,832,011	-
Gross profit (loss)	3,413,331	2,597,248	238,803	4,482,184	3,859,458	(43,468)
Research and development	995,987	321,099	-	2,022,076	311,764	-
Selling, general & administrative	1,969,596	1,400,005	3,006,241	2,210,527	1,947,975	3,866,403
Stock based compensation	-	-	300,369	80,836	-	640,260
Depreciation & amortization	223,149	48,179	206,520	225,662	66,085	132,641
Total operating expenses	3,182,732	1,769,283	3,513,130	4,539,101	2,325,824	4,639,304
Operating income (loss)	224,599	827,964	(3,274,328)	(56,917)	1,533,634	(4,682,772)
Other income	6,802	35,494	10,730	6,056	22,244	68,479
Interest expense	(18,855)	(20,294)	(1,217,107)	(91,188)	(254,229)	(705,764)
Impairment of investment	-	-	(782,000)	-	-	-
Loss before income taxes	212,546	843,164	(5,262,705)	(142,049)	1,301,649	(5,320,057)

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The Company's reportable business segments operate in two geographic locations. Those geographic locations are:

- * United States
- * United Kingdom

The Company evaluates performance and allocates resources based upon operating income. The accounting policies of the reportable segments are the same as those described in the summary of accounting policies. There are inter-segment sales which have been removed upon consolidation and for the purposes of the information shown below.

Information concerning principal geographic areas is presented below according to the area where the activity is taking place for the period ended July 31, 2009 and the year ended October 31, 2008:

	<u>2009</u>	<u>2008</u>
Revenues:		
United States	\$ 5,187,374	\$ 7,362,966
United Kingdom	5,744,209	9,605,956
Corporate and other	-	-
Total Revenues	<u>\$ 10,931,583</u>	<u>\$ 16,968,922</u>
Assets:		
United States	\$ 6,908,785	\$ 4,357,042
United Kingdom	4,556,699	5,478,233
Corporate and other	3,995,098	7,204,009
Total Assets	<u>\$ 15,460,582</u>	<u>\$ 17,039,284</u>

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NOTE 16 - SUBSEQUENT EVENTS

On September 22, 2009, the Company announced that, in light of its ongoing evaluations of its assets, business, management and cash requirements, it was unable to file this Form 10-Q within the prescribed period of time. The Company is reviewing strategic alternatives to enhance operating performance and stockholder value, including restructuring its balance sheet, reducing costs and negotiating with its existing investors to address the Company's liquidity issues and implementing a revised strategic plan.

The Company is exploring ways to raise additional funds for short term working capital purposes. Because of onerous anti-dilution provisions contained in a series of securities purchase agreements entered into in April and May 2007 in combination with the provisions in the Convertible Loan Note Instrument entered into with the Company on 21 February 2009, these together operate as barriers to the Company securing short term funding on realistic economic terms and conditions.

The Company will therefore seek to enter into negotiations with its existing investors with the objective of revising the terms of these investment documents. The Company has also entered into preliminary discussions with the holder of the convertible note to prevent it from taking actions adverse to the Company and to have the debt be reclassified on the Company's books from a short term obligation to a long term obligation.

The Company can give no assurance that it will be successful in any of these efforts. If the Company is unable to raise additional capital in the near future, it may have to curtail its business operations significantly.

Effective September 15, 2009, Jody Frank, Nick Franks, Faith Griffin and Paul Nussbaum resigned their positions as members of the Company's board of directors. In addition, effective September 23, 2009, the Company's Chief Executive Officer and Chief Financial Officer resigned their positions as President and Chief Executive Officer and Chief Financial Officer, respectively. The Chief Executive Officer has agreed to remain as a member of the Board for a six month period to assist the Company in its reorganization efforts.

The Company intends to establish a committee whose function will be to design a reorganization and recapitalization plan. This body is expected to be structured either as a committee of the Board or as a separate body that will include board members as well as representatives of certain of the Company's existing investors and reorganization professionals.

Item 2. Management's Discussion and Analysis or Plan of Operation

Forward-Looking Statements

The information herein contains forward-looking statements. All statements other than statements of historical fact made herein are forward looking. In particular, the statements herein regarding industry prospects and future results of operations or financial position are forward-looking statements. These forward-looking statements can be identified by the use of words such as “believes,” “estimates,” “could,” “possibly,” “probably,” “anticipates,” “projects,” “expects,” “may,” “will,” or “should” or other variations or similar words. No assurances can be given that the future results anticipated by the forward-looking statements will be achieved. Forward-looking statements reflect management’s current expectations and are inherently uncertain. Our actual results may differ significantly from management’s expectations.

The following discussion and analysis should be read in conjunction with our financial statements, included herewith. This discussion should not be construed to imply that the results discussed herein will necessarily continue into the future, or that any conclusion reached herein will necessarily be indicative of actual operating results in the future. Such discussion represents only the best present assessment of our management.

General Overview

Coda Octopus develops, manufactures, sells and services real-time 3D and other sonar products, as well as engineering design and manufacturing services on a worldwide basis. Headquartered in New York City, with research and development, sales and manufacturing facilities located in the United Kingdom, United States and Norway, the Company is also engaged in software development, defense contracting and engineering services through subsidiaries located in the United States and the United Kingdom.

Founded in 1994, Coda operated for ten years as a private company based in the UK. By the late 1990s, the Company had developed a strong reputation as a developer and marketer of high quality software-based products used for underwater mapping, geophysical survey and other related marine applications.

Shortly after September 11, 2001, management was introduced to, and in December 2002 completed the acquisition of, OmniTech AS, a Norwegian Company that had developed and patented a prototype system called the **Echoscope™**. The Echoscope permits accurate three-dimensional visualization, measurement, data recording and mapping of underwater objects – in effect, the ability to “see” an object underwater in real time.

Management believed that real-time 3D sonar could represent a truly disruptive technology with the potential to change industry standard practices and procedures. It envisioned significant applications for this technology in Defense, Underwater Port Security, Oil and Gas Exploration and Security, Bridge Repair, and large-scale Underwater Construction projects. Given these beliefs, the Company decided that the best way to gain access to the capital and the visibility needed to commercialize real time 3D sonar, and to successfully enter multiple worldwide markets in the post 9/11 environment would be to move its headquarters to New York City, and to become a publicly traded company in the United States.

On July 13, 2004 Coda Octopus became a public company through a reverse merger with The Panda Project, Inc., a publicly traded Florida corporation. As a result of the transaction, Coda and its shareholders, including its controlling shareholder Fairwater Technology Group Ltd, were issued 20,050,000 common shares comprising approximately 90.9% of the then issued and outstanding shares of Panda. Subsequently, Panda was reincorporated in Delaware, and changed its name to Coda Octopus Group, Inc. By mid 2005, the Company had completed the move of its headquarters from the UK to New York City.

Since moving to New York, the Company has accomplished a series of objectives:

1. It has raised approximately \$33 million in funds, through three private placements primarily with institutional investors. The Company raised approximately \$8 million in 2006, approximately \$13 million in April/May 2007, and approximately \$12 million in a convertible debt transaction that was completed in February 2008.
2. It has completed the commercialization of the Echoscope and successfully deployed its real-time 3D technology and products on three continents with major corporations, governments, ports, law enforcement agencies and security organizations.
3. It has significantly broadened both its revenue base and its base of expertise in engineering, defense electronics, military and security training, and software development primarily through the acquisition of four privately held companies. Management believes that broadening the base of the Company in these specific areas was necessary to position Coda Octopus as a reliable and experienced contractor, subcontractor and supplier of 3D sonar products and systems on a worldwide basis.

4. Beginning in July 2007, the US Department of Defense (DoD) Technical Support Working Group (TSWG) funded Coda Octopus to build and deliver next-generation Underwater Inspection Systems™ (UIS) for the US Coast Guard and other potential users. The program has included money to build and deliver current systems, as well as a roadmap for their future development. During the year ended October 31, 2007, the Company delivered three UIS systems to the US Coast Guard against a purchase order totaling \$2.59 million. In FY 2008 the Company was funded for an additional \$1.53 million to develop certain mutually agreed technical enhancements to the system. The Company's latest contract with TSWG covers the funding of an additional \$1.4 million for additional enhancements and the delivery of additional systems. The Company believes it has successfully completed the key second-stage enhancements sought by the DoD and the Coast Guard. As a result, management believes that the Company is positioned to build and deploy fully integrated systems that meet the highest standards in the world. They enable users to "see" objects that are smaller than a baseball from a distance of more than 100 meters, and to do so in all kinds of ocean or water conditions at virtually any depth. In addition, the Company through its Colmek subsidiary, has more than 20 years of successful experience as contractor with the Department of Defense, and as a subcontractor with various large primes, most particularly Raytheon.
5. The Company has taken advantage of its first mover status in real-time 3D sonar to start to open up several potentially significant vertical markets in the private sector. Thus far, the three areas of focus have been Dredging, Underwater Construction, and Security. In each of these areas, the Company has selected a lead customer and has worked with that customer to develop and deploy a system that management believes will have wide application throughout the segment. In the case of Rotterdam-based Van Oord, the Company was funded to develop a particular application, and in other cases the Company has financed the development internally.

The Company believes that the largest potential markets for real-time 3D sonar are with government authorities both in the US and throughout the world. Here in the US, the Company has deployed systems Jacksonville Sheriff, FL, and in Contra Costa County, CA, with immediate interest in at least six additional locations. Overseas the Company has deployed systems in Korea, Japan, the United Kingdom and the Middle East, and has significant opportunities in Germany, Singapore, Malaysia and the Netherlands. Our main challenges are the long lead times in purchasing cycles, the current economic environment, and the initial adoption of new technology, which can take several years to effect.

The consolidated financial statements include the accounts of Coda Octopus and our domestic and foreign subsidiaries that are more than 50% owned and controlled. All significant intercompany transactions and balances have been eliminated in the consolidated financial statements. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on management's best knowledge of current events and actions that we may undertake in the future, actual results may differ from those estimates.

Products and Services

We are engaged in 3D subsea technology and are the developer and patent holder of real-time 3D sonar products, which we expect to play a critical role in the next generation of underwater port security. We produce hardware, software and fully integrated systems, which are sold and supported on a worldwide basis, with wide applications in a number of distinct markets:

- Marine geophysical survey (commercial), which focuses around oil and gas, oceanographic research and exploration, where we market to survey companies, research institutions, salvage companies. This was our original focus, with current products spanning geophysical data collection and analysis, through to printers to output geophysical data collected by sonar. We believe that our marine geophysical survey markets are experiencing rapid growth due to: 1) successful new product introductions in recent periods; 2) market-proximity benefits derived from the 2004 relocation to the United States; 3) initial market penetration into new sub-sectors of the marine geophysical survey markets; 4) the high price of oil and gas in the past few years, resulting in unprecedented exploration and production activity, which is still having some effect on the market even with lower current prices.
- Underwater defense/security, where we market to ports and harbors, state, local and federal government agencies, law enforcement agencies and defense contractors. We have recently completed developing and commenced marketing our Underwater Inspection System (UIS™), the first real-time, high resolution, three-dimensional underwater sonar imaging system, which we believe has particularly important applications in the fields of port security, defense and undersea oil and gas development.
- Underwater construction, where our products are used for real-time monitoring of construction which is conducted subsea, a particularly challenging environment. We have also developed for one of our customers a tailored software application to allow the laying of concrete Accropodes™ for constructing breakwaters. The advantage of our real-time system is in giving visibility where previously divers were used to help with the construction, a dangerous and inefficient process.

- Dredging, where our products are used for pre-dredge survey and in a real-time mode where they monitor the quality and precision of the dredge. The advantage we give is in improving the dredge quality and drastically reducing the time involved – for example, if a re-dredge is required, this can be done immediately from the information we provide, instead of days or weeks later, when a new vessel may even have to be used.
- Other applications, such as shallow water hydrography underwater logging, debris survey and treasure hunting.

In addition, through our two engineering services subsidiaries, Coda Octopus Martech Ltd, based in Weymouth, England, UK, and Colmek Systems Engineering, based in Salt Lake City, Utah, US we provide engineering services to a wide variety of clients in the subsea, defense, nuclear, government and pharmaceutical industries. These engineering capabilities are increasingly being combined with our product offerings, bringing opportunities to provide complete systems, installation and support.

For the foreseeable future, we intend to intensify our focus on port security. We believe that in the post 9/11 era there are significant growth opportunities available in that particular market segment because of increased government expenditures aimed at enhancing security. Specifically, we believe that we have the ability to capitalize on this opportunity as a result of:

- First mover advantage in 3D sonar markets based on our patented technology, our research and development efforts and extensive and successful testing in this area that date back almost two decades as well as broad customer acceptance.
- Early recognition of need for 3D real-time sonar in defense/security applications.
- Expansion into new geographies like North America and Western Europe.
- Expansion into new commercial markets like commercial marine survey with innovative products.
- Recent sole source classification for one of our products and its derivatives by certain government procurement agencies.

Further, we believe the Echoscope™ will transform certain segments of the sonar products market. In addition, 3D sonar, currently in the early stages of adoption, has disruptive technology qualities as it has the ability to change industry standard practice in respect of the method for visualization and imaging of underwater objects and environment. Therefore, it will likely change who the suppliers into this market are as well as our market position and that of our competitors. We believe the market opportunity in underwater security and defense could grow at a rapid pace over the next several years.

Critical Accounting Policies

This discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements that have been prepared under accounting principles generally accepted in the United States of America (“GAAP”). The preparation of financial statements in conformity with US GAAP requires our management to make estimates and assumptions that affect the reported values of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported levels of revenue and expenses during the reporting period. Actual results could materially differ from those estimates.

Below is a discussion of accounting policies that we consider critical to an understanding of our financial condition and operating results and that may require complex judgment in their application or require estimates about matters which are inherently uncertain. A discussion of our significant accounting policies, including further discussion of the accounting policies described below, can be found in Note 1, "Summary of Significant Accounting Policies" of our Consolidated Financial Statements.

Revenue Recognition

We record revenue in accordance with the guidance of the SEC's *Staff Accounting Bulletin SAB No. 104* (SAB 104), which supersedes SAB No. 101 in order to encompass EITF No. 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF 00-21).

Revenue is derived from sales of underwater technologies and equipment for imaging, mapping, defense and survey applications. Revenue is also derived through contracts gained by our Martech, Colmek and Innalogic businesses.

Revenue is recognized when conclusive evidence of firm arrangement exists, delivery has occurred or services have been rendered, the contract price is fixed or determinable, and collectability is reasonably assured. No right of return privileges are granted to customers after shipment.

For arrangements with multiple deliverables, we recognize product revenue by allocating the revenue to each deliverable based on the fair value of each deliverable in accordance with EITF No. 00-21 and SAB No. 104, and recognize revenue for equipment upon delivery and for installation and other services as performed. EITF No. 00-21 was effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003.

Our contracts typically require customer payments in advance of revenue recognition. These deposit amounts are reflected as liabilities and recognized as revenue when the Company has fulfilled its obligations under the respective contracts.

Revenues derived from our software license sales are recognized in accordance with Statement of Position (SOP) SOP No. 97-2, "Software Revenue Recognition," and SOP No. 98-9, "Modifications of SOP No. 97-2, Software Revenue Recognition with Respect to Certain Transactions". For software license sales for which any services rendered are not considered essential to the functionality of the software, we recognize revenue upon delivery of the software, provided (1) there is evidence of an arrangement, (2) collection of our fee is considered probable and (3) the fee is fixed and determinable.

Recoverability of Deferred Costs

We defer costs on projects for service revenue. Deferred costs consist primarily of direct and incremental costs to customize and install systems, as defined in individual customer contracts, including costs to acquire hardware and software from third parties and payroll costs for our employees and other third parties.

We recognize such costs in accordance with our revenue recognition policy by contract. For revenue recognized under the completed contract method, costs are deferred until the products are delivered, or upon completion of services or, where applicable, customer acceptance. For revenue recognized under the percentage of completion method, costs are recognized as products are delivered or services are provided in accordance with the percentage of completion calculation. For revenue recognized ratably over the term of the contract, costs are recognized ratably over the term of the contract, commencing on the date of revenue recognition. At each balance sheet date, we review deferred costs, to ensure they are ultimately recoverable. Any anticipated losses on uncompleted contracts are recognized when evidence indicates the estimated total cost of a contract exceeds its estimated total revenue.

Stock Based Compensation

SFAS No. 123, "Accounting for Stock-Based Compensation", established and encouraged the use of the fair value based method of accounting for stock-based compensation arrangements under which compensation cost is determined using the fair value of stock-based compensation determined as of the date of the grant or the date at which the performance of the services is completed and is recognized over the periods in which the related services are rendered. The statement also permitted companies to elect to continue using the current intrinsic value accounting method specified in Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees", to account for stock-based compensation to employees. Prior to the adoption of SFAS 123(R) we elected to use the intrinsic value based method for grants to our employees and directors and have disclosed the pro forma effect of using the fair value based method to account for our stock-based compensation to employees.

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123R (revised 2004), "Share-Based Payment" ("Statement 123R") which is a revision of SFAS No. 123.

Statement 123R supersedes APB opinion No. 25 and amends SFAS No. 95, "Statement of Cash Flows". Generally, the approach in Statement 123R is similar to the approach described in Statement 123. However, Statement 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro-forma disclosure is no longer an alternative. This statement does not change the accounting guidance for share based payment transactions with parties other than employees provided in SFAS No. 123(R). This statement does not address the accounting for employee share ownership plans, which are subject to AICPA Statement of Position 93-6, "Employers' Accounting for Employee Stock Ownership Plans". On April 14, 2005, the SEC amended the effective date of the provisions of this statement. The effect of this amendment by the SEC is that the Company had to comply with Statement 123R and use the Fair Value based method of accounting no later than the first quarter of 2006. We implemented SFAS No. 123(R) on November 1, 2004 using the modified prospective method. The fair value of each option grant issued after November 1, 2004 will be determined as of grant date, utilizing the Black-Scholes option pricing model. The amortization of each option grant will be over the remainder of the vesting period of each option grant. We use the fair value method for equity instruments granted to non-employees and use the Black-Scholes model for measuring the fair value. The stock based fair value compensation is determined as of the date of the grant or the date at which the performance of the services is completed (measurement date) and is recognized over the periods in which the related services are rendered.

Income Taxes

Deferred income taxes are provided using the asset and liability method for financial reporting purposes in accordance with the provisions of Statements of Financial Standards No. 109, "Accounting for Income Taxes". Under this method, deferred tax assets and liabilities are recognized for temporary differences between the tax bases of assets and liabilities and their carrying values for financial reporting purposes and for operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be removed or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the consolidated statements of operations in the period that includes the enactment date.

Purchase price allocation and impairment of intangible and long-lived assets

Intangible and long-lived assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amounts of such assets may not be recoverable. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset, and its eventual disposition. Measurement of an impairment loss for intangible and long-lived assets that management expects to hold and use is based on the fair value of the asset as estimated using a discounted cash flow model.

We measure the carrying value of goodwill recorded in connection with the acquisitions for potential impairment in accordance with SFAS No. 142, Goodwill and Other Intangible Assets". To apply SFAS 142, a company is divided into separate "reporting units", each representing groups of products that are separately managed. For this purpose, we have one reporting unit. To determine whether or not goodwill may be impaired, a test is required at least annually, and more often when there is a change in circumstances that could result in an impairment of goodwill. If the trading of our common stock is below book value for a sustained period, or if other negative trends occur in our results of operations, a goodwill impairment test will be performed by comparing book value to estimated market value. To the extent goodwill is determined to be impaired an impairment charge is recorded in accordance with SFAS 142.

Results of Operations

Introduction

The period ending July 31, 2009 contained two new operations, that of Coda Octopus Tactical Intelligence, Inc and Dragon Design Ltd, both of which were acquired during the period. This should be taken into account when comparing the quarter with the period ending July 31, 2008.

Recent Developments

Cash Framework Agreement

On March 16, 2009 the Company entered a "Cash Framework Agreement" with RBS (the debt holder) which created a debtor book financing package to allow the Company to obtain up to \$2.15M in working capital in exchange for receivables or project financing. As part of the terms of that agreement the Company committed to a cost reduction program (including management pay cuts) to reduce significantly our SG&A, R&D and Capital Expenditure costs. For the year, the Company has targeted combined savings of at least \$2.15m, and we are significantly ahead of schedule and more than fulfilling the requirements of the agreement. This is the beginning of a sustained reorganization program which will enable the Company to continue to reduce costs and operate more efficiently.

Reorganization

The Company has undertaken a reorganization program which will separate the operations into two geographic segments (Europe and the Americas), rather than distinct operating companies. The goal is to centralize functions into the engineering companies located in Weymouth, UK (currently Coda Octopus Martech) and Salt Lake City, US (currently Coda Octopus Colmek). The new configuration will operate in a hub and spoke structure with manufacturing, finance, sales and marketing all centralized in the two engineering companies which will represent the European and the US regions respectively. The 'spokes' will be small sales offices located in strategic outposts geared completely to creating revenues and performing sales and support functions. The R&D unit will become a more horizontal unit working to make advances in our core technology (3D sonar) while helping to spread these advances across the group, as well as promoting technology advances from other parts of the Group. Our products company in Edinburgh will be focused entirely on the Echoscope™ rollout plan for the various markets the Company has identified. The function of this office will be to oversee productizing, developing, documenting and delivering the core product to the defined markets. This change will enable manufacturing, sales, marketing and service of all "mature" products to be concentrated in one location, Weymouth, while allowing our strong sales team in Edinburgh to focus on our core technology which represents our largest potential growth engine. Manufacturing of the Echoscope™ will move to Salt Lake City (Colmek) to comply with the Defense Department's preference to have technology products manufactured domestically. The savings created by these efficiencies will enable the Company to reduce significantly the break-even operating revenue requirement. Although the environment has been challenging, the markets that the Company addresses – engineering, defense, oil and gas, and security – are less affected than many others. The strategy of exploiting our lead in 3D real-time sonar, while tactically streamlining the business to be profitable at a much lower revenue rate, is the operating plan for the foreseeable future. This way, we have preserved and focused our upside potential, while greatly reducing the downside risk by reducing our break-even revenue requirement significantly.

Comparison of Three Months Ended July 31, 2009 (“2009 Period”) to Three Months Ended July 31, 2008 (“2008 Period”)

Revenues. Total revenues for the 2009 period and the 2008 period were \$3,425,030 and \$5,008,525 respectively. This represented a decrease of \$1,583,495, or 31.6%. Of this total, \$491,212 was generated by new operations. Our UK revenues were affected by the change in exchange rates between the two periods, moving from \$1.98 to £1 last year to \$1.51 to £1 this year, reducing our revenues in the 2009 period by \$371,064 on a like for like basis. On stable exchange rates, our revenues would have decreased by \$1,212,431, or 24.2%, from the 2008 period to the 2009 period, a significant decline and one which reflects the poor economic environment in which we’re operating. Marine products sales were very poor for the time of year, resulting from lower than anticipated oil and gas prices which has led to a significant decline in project activity, which will not improve until at least March next year, when the survey season is once again underway. Our engineering businesses, both under new management in the past 12 months, performed significantly better than last year, generating 62.9% of the 2009 period revenues. In addition to better management, this continues to reflect an increased demand for outsourcing as companies downsize their own in-house operations.

Margins. Gross margins were 51.4% in the 2009 period compared with 60.4% for the 2008 period. This reflects the mix of sales, which was dominated by the lower margin engineering businesses. We continue to feel that overall margins for this year will be over 60%.

Research and Development (R&D). R&D costs decreased 70.8% to \$256,929 in the 2009 period from \$880,339 in 2008. Of this reduction, \$204,081 can be attributed to a tax credit claimed during the quarter (and since received) which reduces our expenditure by this amount, with the other \$419,329 attributable to the exchange rate difference and planned cost reductions. Our R&D in the quarter was focused largely on further development of the Echoscope™ and UIS™ tied to the TSWG (US Coast Guard) contract, the third stage of which started in February 2009. Additionally, work continued on productizing different Echoscope™ products, including applications for dredging, underwater construction and security.

Selling, General and Administrative Expenses (SG&A) . SG&A expenses for the 2009 period decreased to \$1,864,880 from \$3,311,267 in 2008, or by 43.7%. Non-cash charges attributable to stock and option compensation, depreciation and amortization, and exchange rate movements were \$187,843 for 2009 and \$433,478 for 2008. The decrease in expenses is partly due to the drop in exchange rate and also attributable to cost reduction measures the Company has introduced, which will have a larger impact as the year continues.

Key areas of expenditure across R&D and SG&A include wages and salaries, where the Company spent \$1,635,990 in 2009 while the 2008 period was \$1,719,375, a decrease of 4.8%; legal and professional fees, including accounting, audit and investment banking services, decreased to \$99,579 in 2009 from \$241,928 in 2008, a decrease of 58.8%; travel decreased to \$152,025 in 2009 from \$186,297 in 2008, a decrease of 18.4%; rent increased to \$183,530 in 2009, from \$164,306, an increase of 11.7%; and marketing decreased to nil from \$294,732 in 2008.

Operating Income/Loss. The Company produced an operating loss for the period of \$361,046 against a loss of \$1,167,795 in 2008.

Interest Expense. Interest expense for the 2009 period was \$432,018, of which \$128,571 was a charge relating to the terminal conversion of the debenture, and \$255,000 was accrued interest, due for payment in August 2009. Cash interest charges for the 2009 period were \$48,447. Costs for 2008 were \$481,876, of which \$255,000 was accrued interest and \$128,571 was a charge relating to the terminal conversion of the debenture. Cash charges for the 2008 period were \$98,305.

Preferred Dividends. During the 2009 period there was a \$15,794 dividend paid on the remaining Series A preferred stock versus \$31,819 in 2008.

Comparison of Nine Months Ended July 31, 2009 (“2009 Period”) to Nine Months Ended July 31, 2008 (“2008 Period”)

Revenues. Total revenues for the 2009 period and the 2008 period were \$10,931,583 and \$13,232,440 respectively. This represented a decrease of \$2,300,857, or 17.4%. Of the 2009 period amount, \$944,450, or 8.6%, was generated by the new operations. Our UK revenues were strongly affected by the change in exchange rates between the two periods, moving from \$1.98 to £1 last year to \$1.51 to £1 this year, reducing our revenues in the 2009 period by \$1,820,267 on a like for like basis. Given this, the decline in revenues, without acquisitions, would have been 10.8% from the 2008 period to the 2009 period, a satisfactory performance given the current economic climate. Our marine products business has suffered due to the oil price decline from last year, with 2009 period sales at \$3,571,018, down from \$6,832,011 in the 2008 period. Our engineering businesses, both under new management in the past 12 months, performed significantly better than last year generating 53.7% of the 2009 period revenues in total, against 36.3% for the 2008 period. In addition to better management, this reflects an increased demand for outsourcing as companies downsize their own in-house operations.

Margins. Gross margins were 57.2% in the 2009 period compared with 62.7% for the 2008 period. The drop is due to the higher proportion of revenues derived from our engineering businesses and a lower rate of sale of our flagship Echoscope product for the 2009 period. The lack of Echoscope™ sales results in our margins being below our targeted 60%. We continue to feel that overall margins for this year will be over 60%.

Research and Development (R&D). R&D costs decreased 43.6% to \$1,317,087 in the 2009 period from \$2,333,840 in 2008. This partly reflects the drop in exchange rates between the 2009 and 2008 periods, which, while reducing revenues also reduces costs. It also reflects active cost reduction by the Company and a tax credit for \$204,081 which was claimed in the period and subsequently received. Our R&D in the period was focused on further development of the Echoscope™ and UIS™ tied to the TSWG (US Coast Guard) contract, the second stage of which finished in January 2009 and the third stage of which started in February 2009. Additionally, work continued on productizing different Echoscope™ products, including applications for dredging, underwater construction and security.

Selling, General and Administrative Expenses (SG&A). SG&A expenses for the 2009 period decreased to \$7,154,059 from \$9,170,389 in 2008, or by 21.9%. Non-cash charges attributable to stock and option compensation, depreciation and amortization, and exchange rate movements were \$779,298 for 2009 and \$1,323,029 for 2008. This is partly due to the drop in exchange rate and also attributable to cost reduction measures the Company has introduced, which will have a larger impact as the year continues.

Key areas of expenditure across R&D and SG&A include wages and salaries where the Company spent \$5,331,368 in 2009 while the 2008 period was \$5,911,077, a decrease of 9.8%; legal and professional fees, including accounting, audit and investment banking services, decreased to \$906,375 in 2009 from \$974,053 in 2008, a decrease of 6.9%; travel decreased to \$334,144 from \$521,481, a decrease of 35.9%; rent decreased to \$492,192 in 2009, from \$562,036, a decrease of 12.4%; and marketing decreased to \$459,713 from \$913,760 in 2008, a decrease of 49.7%.

Debt Modification Cost. During the 2009 period, we incurred non-recurring costs, primarily in the form of legal fees, connected with putting the new Cash Framework Agreement in place with the holder of the convertible bond. These costs amounted to \$162,832 against no similar expenditure in 2008.

Operating Income/Loss. The Company produced an operating loss for the period of \$2,221,765 against a loss of \$3,206,055 in 2008. It is worthwhile noting that the losses for the 2009 period were all made in the first quarter of the year, with a slightly better than break-even result achieved since.

Interest Expense. Interest expense for the 2009 period was \$1,256,256, of which \$385,713 was a charge relating to the terminal conversion of the debenture, and \$765,000 was accrued interest. This left cash interest charges of \$105,543 for the period. Note that a cash payment of \$1,530,000 covering bond interest was made in the period. Costs for 2008 were \$1,051,181, of which \$450,050 was accrued bond interest, \$219,921 was a charge relating to the terminal conversion of the debenture, leaving \$381,210 of cash charges.

Preferred Dividends. During the 2009 period there was a \$47,382 dividend paid on the remaining Series A preferred stock versus \$106,843 in 2008.

Liquidity and Capital Resources

As of July 31, 2009 the Company had negative working capital of \$8,534,795 and cash totaling \$574,905.

The net loss for the period of \$4,206,995 generated a cash flow deficit from operations of \$1,415,685 in the 2009 Period, compared to a deficit of \$4,117,784 in 2008. During the 2009 Period, we also invested around \$405,000 in assets for use within our various businesses and the completion of two small acquisitions (see note 14 to the financial statements). In the 2009 period, we made our first interest payment on the Secured Convertible Debenture (see Note 12) which we closed in February 2008, for a total of \$1,020,000. There was also a hit to our cash through exchange rate movements which contributed \$62,543 to the cash outflow and a net increase in cash subject to restriction of around \$378,000, giving a total cash decrease of around \$3,321,000 for the period.

Under the terms of the \$12M convertible debenture issued in February 2008 (see Note 12) , the Company was required to apply \$6M of the proceeds to working capital and the remaining \$6M for certain approved acquisitions Unless an alternative use of proceeds was approved, if the Company failed to comply with these covenants, the debenture holders would be entitled to call for the redemption of notes having a face value of \$6M within 30 days of the Company failing to make the approved acquisition.

As of October 31, 2008, the Company failed to make the approved acquisition and therefore was not in compliance under the terms of the debenture. On March 16, 2009, the Company and the Noteholder have entered into a Cash Control Framework Agreement, pursuant to which it is assumed that, subject to the Company being fully compliant with the terms of this agreement and those set out in the Transaction Documents entered into between the Company and the Noteholder on February 21, 2008, no adverse actions will be taken by the Noteholder. The agreement provides, among other things, for the placement of approximately \$2.15 million into a segregated cash account. Under the terms of the agreement, we may request the release of funds from the account from time to time for working capital purposes subject to the Noteholder's consent and agreed upon terms and conditions. Under the terms of the agreement, we must also adhere to a strict cost cutting program which involves reducing our SG&A, R&D and capital expenditure by an annualized \$3.35 million.

Our plan to move from loss to profit is based upon intensifying our focus on Echoscope™ applications generally, as well as reducing costs considerably from last year's total. In the short term, our plan involves, specifically:

- Continuing to sell our current range of products into a mixture of commercial, defense and security markets, increasing sales of these products over the course of this financial year - we have seen strong growth recently.
- Continuing to develop and sell complete turnkey systems based around our leading Echoscope™ 3D technology, to open markets in law enforcement and inspection - a great deal of our R&D expenditure has been directed towards refining our product with a view to completing sales this year that are currently in our pipeline.
- Continuing to deliver to the Coast Guard on the next stage contract, which we were awarded in February. Work on stage 3 has already begun in the second quarter of this year and continues until at least the end of the financial year.
- Delivering on our first port security solution contract through the provision of our unique 3D technology and other products and services, enabling us to provide complete solutions.
- Leveraging our subsidiaries to take advantage of our lead in underwater sonar technology by cross marketing all group products and services from each company.
- Continuing to review and refocus our cost base where necessary to achieve a cost level commensurate with our current level of activity.

Through these measures, we aim to move from cash negative for last year and the first quarter of this year to cash positive. We also aim to move from heavily loss-making for the past 2 years to profitable for the coming year, prior to any non-cash charges made to our income statement. Although we intend to pursue our plans aggressively as set forth in the previous paragraph, there can be no assurance that we will be successful in our attempt to make the Company profitable in the near future, or ever.

Inflation and Foreign Currency

The Company maintains its books in local currency: US Dollars for the parent holding Company in the United States of America and the US operations, Pounds Sterling for UK operations and Norwegian Kroner for Norwegian operations.

The Company's operations are split between the United States and United Kingdom through its wholly-owned subsidiaries, with a significant proportion of revenues and costs incurred outside of the US. As a result, fluctuations in currency exchange rates may significantly affect the Company's sales, profitability and financial position when the foreign currencies of its international operations are translated into U.S. dollars for financial reporting. In addition, we are also subject to currency fluctuation risk with respect to certain foreign currency denominated receivables and payables. Although the Company cannot predict the extent to which currency fluctuations may, or will, affect the Company's business and financial position, there is a risk that such fluctuations will have an adverse impact on the Company's sales, profits and financial position. Because differing portions of our revenues and costs are denominated in foreign currency, movements could impact our margins by, for example, decreasing our foreign revenues when the dollar strengthens and not correspondingly decreasing our expenses. The Company does not currently hedge its currency exposure. In the future, we may engage in hedging transactions to mitigate foreign exchange risk.

It is the opinion of the Company that inflation has not had a material effect on its operations.

Financing Activities

Equity Offerings

On April 30, 2006, we issued 2,377 shares of our Series A Preferred Stock to a group of individual investors for total cash consideration of \$407,100. An additional 4,943.88 shares of our Series A Preferred Stock were issued to various individuals as repayment of \$734,628 in debt. The aggregate value of these issuances was \$1,141,728 for a total of 7320.88 shares.

In June 2006, we issued to one institutional investor units consisting of 23,000 shares of our Series B Preferred Stock and two five-year warrants to purchase 4.6 million shares of our common stock at a price ranging from \$1.30 to \$2.00 per share for total cash consideration of \$2,300,000. Of these shares of Series B Preferred Stock, 4,819 were converted into 481,900 shares of common stock in April 2007 and 18,181 shares of Series B Preferred Stock were repurchased by us. These repurchased shares have now been cancelled.

In July 2006, we issued to two individual investors 820 shares of our Series A Preferred Stock for a total cash consideration of \$82,000. These have since been converted into 82,000 shares of our common stock.

From September 2006 through January 2007, we issued to one institutional investor units consisting 23,000 shares of our Series B Preferred Stock and four five year warrants to purchase 4.6 million shares of our common stock at a price ranging from \$1.3 to \$2.00 per share and 650,000 shares of our Common Stock for a total cash consideration of \$2,300,000. The 23,000 shares of Series B Preferred Stock were converted into 2,300,000 shares of our common stock in March 2007.

On October 31, 2006, we issued to one investor 500 shares of our Series A Preferred Stock for a total consideration of \$50,000. These have since been converted into 50,000 shares of our common stock.

In January 2007, we issued to one investor 3,000 shares of our Series B Preferred Stock plus five-year warrants to purchase 300,000 shares of our common stock at \$1.30 per share and five-year warrants to purchase 300,000 shares of our common stock at \$1.70 per share for a total cash consideration of \$300,000. The 3,000 shares of Series B Preferred Stock have since been converted into 300,000 shares of our common stock.

In April 2007 we issued to an individual investor 25,000 shares of our common stock plus five-year warrants to purchase the same amount of shares of common stock (of which 12,500 may be purchased at \$1.30 and the balance at \$1.70 per share) for a total of \$25,000.

In April and May, 2007, the Company consummated a series of securities purchase agreements (the "Purchase Agreements") with a group of accredited individual and institutional investors providing for the sale and issuance of 15,025,000 shares of our common stock and five-year warrants to purchase 7,512,400 shares of common stock at \$1.30 per share and five-year warrants to purchase 7,512,500 shares of common stock at \$1.70 per share. Gross proceeds from the offering amounted to \$15,025,000, generating \$13,877,980 after costs. Also, in the period, we raised \$800,000 from the sale of preferred stock and warrants, with the preferred stock since converted into common stock. We also issued five-year warrants to purchase 2,400,000 shares of our common stock at \$1.00 per share as part of placement agent fees.

Secured Convertible Debentures

On February 21, 2008 we entered into and completed the transactions contemplated under a series of agreements providing for the issuance to a London based institutional investor, The Royal Bank of Scotland plc of senior secured convertible notes in the principal amount of \$12,000,000 (the "Notes"). The Notes are secured by all of the assets of the Company and its subsidiaries and mature 84 months after the date of issuance at which time they are redeemable at 130% of the face amount of the Notes. The Notes accrue interest at the annual rate of 8.5% which is payable semi-annually in arrears. The Notes also stipulate additional interest payments of 2% per annum above the base rate quoted by The Royal Bank of Scotland plc from time to time, in the event that the semi-annual interest payments are not paid by us on the due dates. All of these amounts are payable by us in cash. Of the proceeds, \$6,000,000 constituted a specific purpose loan and in the event that we failed to use the proceeds as agreed within 12 months from the closing, then, unless alternative investments were approved by the holders of the Notes, this \$6,000,000 was repayable in February 2009. In such case there will be a partial redemption of 60 of the notes (having an aggregate nominal value of \$6 million). Pursuant to the terms of the agreement, a further \$1 million of the proceeds has been retained by RBS to secure the performance of certain contractual obligations of the Company. Upon performance of these by us, this will be released. We expect such release to occur no later than February 2009. During the period from February 2008 to December 2008 in which this \$1million was retained we earned approximately \$17,000 interest on this restricted cash balance based on RBS's internal overnight funds rate. During the term, the Notes are convertible into our common stock at the option of the Noteholders at a conversion price of \$1.05. We may also force the conversion of these Notes into our common stock after two years in the event that we obtain a listing on a national exchange and our stock price closes on 40 consecutive trading days at or above \$2.50 between the second and third anniversaries of this agreement; \$2.90 between the third and fourth anniversaries of this agreement; and \$3.50 after the fourth anniversary of this agreement or where the daily volume weighted average price of our stock as quoted on OTCBB or any other US National Exchange on which our securities are then listed has, for at least 40 consecutive trading days closed at the agreed price.

In August 2008, we notified the Noteholder that we believed that we would be unable to use the \$6,000,000 in the manner agreed to under the terms of the Notes. In response, the Noteholder orally consented to the use of an additional \$2 million of the \$6,000,000 for general working capital purposes. In January 2009, we notified the Noteholder that the balance of the \$6,000,000 had fallen below \$4 million. On March 16, 2009, the Company and the Noteholder entered into a Cash Control Framework Agreement, pursuant to which it is assumed that, subject to the Company being fully compliant with the terms of this agreement and those set out in the Transaction Documents entered into between the Company and the Noteholder on February 21, 2008, no adverse actions will be taken by the Noteholder. The agreement provides, among other things, for the placement of approximately \$2.15 million into a segregated cash account. Under the terms of the agreement, we may request the release of funds from the account from time to time for working capital purposes, subject to the Noteholder's consent and agreed upon terms and conditions. Under the terms of the agreement, we must also adhere to a strict cost cutting program which involves reducing our SG&A, R&D and capital expenditure by an annualized \$3.35 million. We believe that the terms of this agreement may provide us with sufficient liquidity to operate for fiscal 2009.

Our ability to survive current financial difficulties resulting from our cash flow deficit is dependent on our capacity to generate revenues from the sale of our products and services. In addition, we are highly dependent on the discretion of the Noteholder to release cash to us to cover our operating expenses.

Nevertheless, by adjusting our operations and development to the level of capitalization, we believe we will have sufficient capital resources to meet projected cash flow deficits. However, if during fiscal 2009 or shortly thereafter, we are not successful in generating sufficient liquidity from operations or in raising sufficient capital resources, on terms acceptable to us, this could have a material adverse effect on our business, results of operations liquidity and financial condition. We estimate that we need to generate \$2 million in cash by the end of January 2010 in addition to the funds potentially available to us under the Cash Control Framework Agreement to be able to continue our operations at their current levels. We will also need to increase our sales significantly in the period following. We are currently negotiating with several large prospective US-based customers. Successful sales to these entities are expected to provide us with the requisite liquidity. However, there can be no assurance that we will be successful in gaining these additional customer contracts.

Other than disclosed herein, we presently do not have any available credit, bank financing or other external sources of liquidity. Due to our brief history and historical operating losses, our operations have not been a source of liquidity. 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.

Our current financing options are limited due to onerous anti-dilution provisions contained in the Purchase Agreements entered into in April and May 2007. Under the terms of the Purchase Agreements, the investors who purchased stock in the Company thereunder are entitled to receive shares of common stock without additional consideration any time we sell equity securities at a price per share of less than \$1.00. Therefore, we will likely have to renegotiate the terms of the Purchase Agreements before we are able to raise additional equity financing. Financing transactions may include the issuance of equity or debt securities, obtaining credit facilities, or other financing mechanisms. However, the trading price of our common stock and the downturn in the U.S. stock and debt markets could make it more difficult to obtain financing through the issuance of equity or debt securities. In addition, our stock was recently stricken from the OTC Bulletin Board for failure to make our periodic filings on a timely basis. This will further impact on the liquidity of our stock putting further downward pressure on its price and making it less likely that we will be able to raise equity financing.

We will seek to enter into negotiations with our existing investors with the objective of revising the terms of the existing investment documents. We have also entered into preliminary discussions with the holder of the convertible note to prevent it from taking actions adverse to us and to have the debt be reclassified on our books from a short term obligation to a long term obligation. We can give no assurance that we will be successful in any of these efforts. If we are unable to raise additional capital in the near future, it may have to curtail its business operations significantly.

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. Further, 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.

Item 4T. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our principal executive and financial officers, as appropriate to allow timely decisions regarding required disclosure.

The Company's management, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial (and principal accounting) Officer, carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Exchange Act) as of July 31, 2009. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were ineffective as of the end of the period covered by this report.

The Company continues to improve procedures with regard to its disclosure controls and procedures.

(b) Changes in Internal Controls.

There was no change in our internal controls over financial reporting that has materially affected, or is reasonable likely to materially affect, our internal control over financial reporting during the quarter covered by this Report.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we may become involved in various lawsuits and legal proceedings which arise in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm our business. Except as described below, we are currently not aware of any such legal proceedings that we believe will have, individually or in the aggregate, a material adverse affect on our business, financial condition or operating results.

We are currently engaged in a lawsuit involving the former Chief Executive Officer of our subsidiary, Coda Octopus Colmek, Inc. (Scott DeBo v Miller & Hilton, Inc. d/b/a Colmek Systems Engineering and Coda Octopus Group, Inc. File No. 080923661). Mr DeBo claims breach of his employment contract, tortious interference with his contract, termination in violation of public policy and failure to pay wages when due. He filed a complaint and an amended complaint on November 10, 2008 and December 10, 2008, respectively. We answered the amended complaint denying Mr. DeBo's allegations, raising affirmative defenses on December 22, 2008 and intend to defend ourselves vigorously.

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

Not Applicable.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

- 31 Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(a)
- 32 Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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.

Coda Octopus Group, Inc.
(Registrant)

Date: October 15, 2009

/s/ Geoff Turner
Geoff Turner
President and Chief Executive Officer

Date: October 15, 2009

/s/ Geoff Turner
Geoff Turner
Chief Financial Officer

CHIEF EXECUTIVE OFFICER CERTIFICATION

I, Geoff Turner, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Coda Octopus Group, Inc.:
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of circumstances under which such statements were made, not misleading with respect to the period covered by this report.
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operation and cash flows of the registrant as of, and for, the periods presented in this report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information: and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 15, 2009

/s/ Geoff Turner

Geoff Turner
President and Chief Executive Officer

CHIEF FINANCIAL OFFICER CERTIFICATION

I, Geoff Turner, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Coda Octopus Group, Inc.:
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of circumstances under which such statements were made, not misleading with respect to the period covered by this report.
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operation and cash flows of the registrant as of, and for, the periods presented in this report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information: and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 15, 2009

/s/ Geoff Turner

Geoff Turner

Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report of Coda Octopus Group, Inc. (the "Company") on Form 10-Q for the quarter ended July 31, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Geoff Turner, President and Chief Executive Officer, and Chief Financial Officer, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

- (1) This report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Geoff Turner

Geoff Turner

President, Chief Executive Officer and Chief Financial Officer

Date: October 15, 2009
