

INNOVA HOLDINGS  
Form 10QSB  
May 15, 2006

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

**FORM 10-QSB**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934** for the quarterly period ended March 31, 2006.

**TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934** for the transition period from \_\_\_\_\_ to \_\_\_\_\_.

*Commission file number: 000-33231*

**INNOVA HOLDINGS, INC.**

(Name of Small Business Issuer in its charter)

Delaware  
(State or other jurisdiction  
of incorporation or  
organization)

95-4868120  
(IRS Employer  
Identification No.)

17105 San Carlos Boulevard, Suite A6151, Fort Myers, Florida 33931  
(Address of principal executive offices)

(239) 466-0488  
(Issuer's telephone number)

Check whether issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or 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

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY  
PROCEEDINGS DURING THE PRECEDING FIVE YEARS**

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court: Yes  No

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

**APPLICABLE ONLY TO CORPORATE ISSUERS**

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: As of May 1, 2006, the issuer had 604,861,850 shares of common stock, \$.001 par value, issued and outstanding.

Transitional Small Business Issuer Format (Check One): Yes  No

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**INNOVA HOLDINGS, INC.**  
**MARCH 31, 2006 QUARTERLY REPORT ON FORM 10-QSB**

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**INNOVA HOLDINGS, INC.**  
**CONSOLIDATED BALANCE SHEET**

March 31, 2006  
(Unaudited)

**ASSETS**

|                             |           |                |
|-----------------------------|-----------|----------------|
| Current assets              |           |                |
| Cash                        | \$        | 30,157         |
| Accounts receivable         |           | 38,217         |
| Inventory                   |           | 39,072         |
| Total current assets        |           | 107,446        |
|                             |           |                |
| Property and equipment, net |           | 116,604        |
|                             |           |                |
| Deferred financing cost     |           | 346,285        |
| <b>TOTAL ASSETS</b>         | <b>\$</b> | <b>570,335</b> |

**LIABILITIES AND STOCKHOLDERS' DEFICIT**

|   |           |                    |
|---|-----------|--------------------|
| Current liabilities   |           |                    |
| Current maturities of long-term debt  | \$        | 67,382             |
| Accounts payable  |           | 851,092            |
| Accrued expenses  |           | 1,446,251          |
| Notes payable   |           | 965,801            |
| Dividend payable  |           | 35,971             |
| Derivative liability  |           | 31,800             |
| <b>TOTAL CURRENT LIABILITIES</b>  |           | <b>3,398,297</b>   |
|   |           |                    |
| Long-term debt  |           | 921,718            |
|   |           |                    |
| Commitments   |           |                    |
|   |           |                    |
| <b>STOCKHOLDERS' DEFICIT:</b>   |           |                    |
| Preferred stock, \$.001 par value, 10,000,000 shares authorized,<br>492,000 shares issued and outstanding   |           | 492                |
| Common stock, \$.001 par value, 900,000,000 shares authorized,<br>569,302,879 shares issued and outstanding |           | 569,303            |
| Additional paid-in capital  |           | 6,304,996          |
| Accumulated deficit   |           | (10,624,471)       |
| <b>Total Stockholders' Deficit</b>  |           | <b>(3,749,680)</b> |
|   |           |                    |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT</b>  | <b>\$</b> | <b>570,335</b>     |

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



**INNOVA HOLDINGS, INC.**  
**STATEMENTS OF OPERATIONS**  
**Three Months Ended March 31, 2006 and 2005**  
**(Unaudited)**

|  | 2006           | 2005<br>As restated |
|--|----------------|---------------------|
| Revenues   | \$ 136,490     | \$ -                |
| Cost of revenues   | 107,690        | -                   |
| Gross profit   | 28,800         | -                   |
| Operating expenses:  |                |                     |
| Selling, general and administrative                              | 942,909        | 84,343              |
| Outside services   | 50,259         | 139,763             |
| Legal fees   | 27,034         | 13,998              |
| Professional fees  | 18,705         | 295,012             |
| Depreciation and amortization                                    | 5,450          | 416                 |
| Total operating expenses   | 1,044,357      | 533,532             |
| Loss from operations   | (1,015,557)    | (533,532)           |
| Interest expense   | (86,782)       | (23,537)            |
| Derivative income (loss)   | (13,992)       | -                   |
| Net loss   | \$ (1,116,331) | \$ (557,069)        |
| Loss applicable to common shareholders:                          |                |                     |
| Net loss   | \$ (1,116,331) | \$ (557,069)        |
| Beneficial conversion features and accretions of preferred stock | (22,610)       | (144,000)           |
| Loss applicable to common shareholders                           | \$ (1,138,941) | \$ (701,069)        |
| Loss per common share:   |                |                     |
| Basic and diluted  | \$ (0.00)      | \$ (0.00)           |
| Weighted average shares outstanding:                             |                |                     |
| Basic and diluted  | 519,917,518    | 371,296,897         |

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

**INNOVA HOLDINGS, INC**  
**STATEMENTS OF CASH FLOWS**  
**Three Months Ended March 31, 2006 and 2005**  
**(Unaudited)**

|   | 2006             | 2005             |
|---|------------------|------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                             |                  |                  |
| Net loss  | \$ (1,116,331)   | \$ (557,069)     |
| Adjustments to reconcile net loss to cash used in operating activities: |                  |                  |
| Depreciation and amortization   | 5,450            | 416              |
| Stock based compensation  | 530,021          | -                |
| Amortization of deferred financing costs                                | 2,900            | -                |
| Amortization of debt discount   | 56,021           | -                |
| Derivative loss   | 13,992           | -                |
| Changes in assets and liabilities:                                      |                  |                  |
| Decrease in inventory   | 21,090           | -                |
| Increase in accounts receivable   | (38,217)         | -                |
| Increase in accounts payable  | 6,544            | 234,563          |
| Decrease in accrued expenses  | (73,351)         | 205,129          |
| <b>CASH FLOWS USED IN OPERATING ACTIVITIES</b>                          | <b>(591,881)</b> | <b>(116,961)</b> |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                             |                  |                  |
| Additions to property and equipment                                     | (5,963)          | -                |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                             | <b>(5,963)</b>   | <b>-</b>         |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                             |                  |                  |
| Proceeds from sale of common stock                                      | 696,215          | -                |
| Proceeds from sale of preferred stock                                   | -                | 148,166          |
| Payments of notes payable   | (75,000)         | -                |
| <b>CASH FLOW FROM FINANCING ACTIVITIES</b>                              | <b>621,215</b>   | <b>148,166</b>   |
| <b>NET INCREASE (DECREASE) IN CASH</b>                                  | <b>23,371</b>    | <b>31,205</b>    |
| Cash, beginning of period   | 6,786            | 2,794            |
| Cash, end of period   | \$ 30,157        | \$ 33,999        |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>                              |                  |                  |
| Interest paid   | \$ 4,313         | \$ 19,876        |
| Income taxes paid   | -                | \$ -             |
| <b>Supplemental Disclosure of Non-cash Transactions:</b>                |                  |                  |
| Amortization of deferred financing costs                                | \$ 49,315        | \$ -             |
| Conversion of series A preferred stock                                  | \$ 58,840        | \$ -             |

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

**INNOVA HOLDINGS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

**NOTE 1 - BASIS OF PRESENTATION**

The accompanying unaudited interim financial statements of InnoVA Holdings, Inc. have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules of the Securities and Exchange Commission ("SEC"), and should be read in conjunction with the audited financial statements and notes thereto contained in the Company's registration statement filed with the SEC on form 10-KSB. In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of financial position and the results of operations for the interim periods presented have been reflected herein. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year. Notes to the financial statements which would substantially duplicate the disclosure contained in the audited financial statements for the most recent fiscal year ended December 31, 2005 as reported in form 10-KSB have been omitted.

**NOTE 2 - STOCK BASED COMPENSATION**

In accordance with SFAS 123(R), the Company has implemented the modified prospective method which recognizes compensation expense at previously determined fair values for all unvested awards granted to employees prior to the effective date of adoption and fair value for all new share-based payments made after adoption. The effect on net loss related to the adoption of FAS 123(R) was \$358,271.

The following tabular presentation reflects net loss applicable to common stockholders for share-based employee compensation as of March 31, 2006 and 2005:

|  | <b>2006</b>    | <b>2005</b>  |
|--|----------------|--------------|
| Net loss applicable to common shareholders:  | \$ (1,138,941) | \$ (701,069) |
| Share-based employee compensation included in net loss                                     | \$ 530,021     | -            |
| Pro forma net loss applicable to common shareholders for share-based employee compensation |                | (45,500)     |
| Pro forma net loss applicable to common shareholders                                       |                | \$ (746,569) |
| Loss per common share:   |                |              |
| Basic and diluted - as reported  |                | \$ (0.00)    |
| Basic and diluted - pro forma  |                | \$ (0.00)    |

For new share-based payments made after adoption, the Company has estimated fair value at the date of grant using the Flexible Binomial Model, which includes a volatility assumption of 44.19%, a risk-free rate of 2.45% and the related term of the share-based payments ranging from immediate to five years. In determining fair value of share-based payments as of March 31, 2006, management has estimated a forfeiture rate of 5%.



During the first quarter of 2006 there were 20,000,000 options granted to directors and 13,000,000 options granted to employees. The share purchase options granted to directors vested upon the award and for employees the options vest evenly over a three year period from date of grant. All options granted in the first quarter are exercisable at \$.01 per share and they expire ten years after the grant date. The options had a fair value of \$210,833 on the grant date.

In March 2006 the Company modified 18,000,000 options granted in 2005 to the Chief Financial Officer by changing their vesting from a three year period to 100% vested as of December 14, 2005 and by changing the exercise price from \$.036 to \$.01. And the Company modified 15,000,000 options granted to the Chief Executive Officer and 5,658,621 options granted to an employee in 2005 by changing the exercise price from \$.017 per share to \$.01 per share. Additionally, the Chief Financial Officer received a bonus of 5,625,000 shares of the Company's common stock on March 10, 2006, which was valued at \$50,000 based on \$.009 per share, the closing price of the Company stock on the previous day. In connection with the modification the Company recorded a charge of \$260,000.

### **NOTE 3 - CAPITAL STOCK**

On June 14, 2005, Innova entered into a Standby Equity Distribution Agreement with Cornell Capital Partners. Under the Standby Equity Distribution Agreement, Innova may issue and sell to Cornell Capital Partners common stock for a total purchase price of up to \$10,000,000. The purchase price for the shares is equal to their market price, which is defined in the Standby Equity Distribution Agreement as the lowest volume weighted average price of the common stock during the five trading days following the date notice is given by the Company that it desires an advance. The amount of each advance is subject to an aggregate maximum advance amount of \$400,000, with no advance occurring within five trading days of a prior advance. Cornell Capital Partners received a one-time commitment fee of 2,608,699 shares of the Company's common stock equal to approximately \$90,000 based on Innova's stock price on May 4, 2005, when the term sheet for the Standby Equity Distribution Agreement was signed. Cornell Capital Partners is paid a fee equal to 5% of each advance, which is retained by Cornell Capital Partners from each advance. The Company will pay a structuring fee of \$500 for each advance made under the Standby Equity Distribution Agreement. The Company also issued to Cornell Capital Partners its promissory note for \$300,000, which is payable by December 31, 2006. The note does not bear interest except in the event of a default.

During the first quarter of 2006, the Company utilized the Standby Equity Distribution Agreement and sold 74,232,572 shares of common stock to Cornell Capital for gross proceeds of \$635,000. Of the gross proceeds received, Cornell was paid \$31,750 in commitment fees and \$4,500 in structuring fees.

On June 23, 2004, the Company entered into a private placement and sold 125,000 shares of Series A Preferred Stock for \$125,000. Each share of the Series A Preferred Stock (i) pays a dividend of 5%, payable at the discretion of the Company in cash or common stock, (ii) is convertible immediately after issuance into the number of shares of common stock equal to \$1.00 divided by a conversion price equal to the lesser of 75% of the average closing bid price of the Company's common stock over the twenty trading days preceding conversion or \$0.005, (iii) has a liquidation preference of \$1.00 per share, (iv) must be redeemed by the Company five years after issuance at \$1.00 per share plus accrued and unpaid dividends, (v) may be redeemed by the Company at any time for \$1.30 per share plus accrued and unpaid dividends, (vi) grants rights to acquire one share of Common Stock for each share of Common Stock issued on conversion at a price per share equal to the average of the closing price of the common stock on the five business days preceding the date of conversion for a period of one year from the date of conversion and, (vii) has no voting rights except when mandated by Delaware law.

Of the \$125,000 proceeds received from the issuance of the Series A Preferred Stock, \$50,000 was allocated to the beneficial conversion feature embedded in the Series A Preferred Stock on the date of issuance based on a conversion price of \$.005 per share. Of this amount, \$48,300 was the unamortized embedded beneficial feature assumed as part of the reverse merger with Robotic Workspace Technologies, Inc. The beneficial conversion feature is being amortized over five (5) years and accordingly \$3,600 was amortized through Accumulated Deficit through December 31, 2004.

Additionally, the excess of the aggregate fair value of the common stock to be issued upon conversion over the \$125,000 of proceeds received when the Series A Preferred Stock was issued amounted to \$50,000.

During the quarter ended September 30, 2005, 43,550 shares of Series A Preferred Stock were converted into 8,710,001 shares of Common Stock of the Company. Accordingly, \$13,832 of the unamortized beneficial conversion feature associated with the converted Series A Preferred Stock was amortized to Accumulated Deficit and credited to Additional Paid in Capital during the three months ended September 30, 2005. Additionally, \$8,258 of the remaining beneficial conversion feature was amortized through Accumulated Deficit for the twelve months ended December 31, 2005. The total beneficial conversion feature amortized through Accumulated Deficit associated with the Series A Preferred Stock was \$22,090 through the twelve months ended December 31, 2005.

During the quarter ended March 31, 2006, the remaining \$81,450 shares of the Series A preferred stock were converted into 16,290,000 shares of the Company's common stock, and dividends were converted into 112,168 shares of the Company's common stock. Accordingly, all of the remaining unamortized beneficial conversion feature associated with the converted Series A Preferred Stock totaling \$22,610 was amortized to Accumulated Deficit and credited to Additional Paid in Capital during the three months ended March 31, 2006. As of March 31, 2006 there were rights outstanding to acquire 25,000,000 shares of the Company's common stock associated with the conversion of Series A Preferred Stock into common stock of the Company. These rights have a weighted average exercise price of \$0.018 per share and a weighted average remaining term of 8 months as of March 31, 2006.

During the first quarter ended March 31, 2006 the Company obtained an additional \$100,650 of funds through the private placement sale of 11,594,093 shares of the Company's common stock at prices ranging from \$.0073 to \$.0171 per share.

On January 24, 2006, the Company entered into a Letter Agreement (the "Agreement") with CoroWare, Inc. ("CoroWare"), under which the Company agreed to purchase and CoroWare agreed to sell all of its assets including, without limitation, all hardware, software, employee relations, customer contacts in the military and homeland security markets, contacts with Microsoft, Inc. and all other customers, and all other tangible and intangible assets including all developed software.

CoroWare is a systems integration firm with particular expertise in the area of mobile service robotics. CoroWare is the only mobile service robotics company to join the Microsoft® Windows Embedded Partner Program. CoroWare uses the Windows XP Embedded operating system to power its mobile service robots, which are based on de facto standards, off-the-shelf hardware and proven software.

The Letter Agreement indicates that the purchase price will consist of: (a) up to \$450,000 in cash, of which \$100,000 is non-contingent and the balance of \$350,000 is contingent based on sales and the gross profit percentage of the CoroWare business; (b) up to 30,000,000 restricted shares of the Company's common stock, of which 5,000,000 are non-contingent and vest in three equal annual installments commencing one year from the closing, and the balance of 25,000,000 is contingent based on sales and the gross profit percentage of the Coroware business; and (c) 2,000,000 common stock options exercisable at \$.018 per share, vesting in three equal annual installments commencing one year from the closing, with a term of ten years from the date of grant, to be allocated to employees of CoroWare. In addition, the Company shall assume specific liabilities of CoroWare in the amount of \$98,168, and no other liabilities. The purchased business assets will be placed in a new subsidiary of the Company, which will change its name to "CoroWare" after the closing.

In the event that the Company enters into a binding agreement to sell all of its stock or assets, or all of the assets acquired from CoroWare, prior to receipt by CoroWare of all of the restricted share portion of the purchase price to be paid under the Agreement, then the remaining portion of the restricted share component of the purchase price shall be delivered to CoroWare immediately prior to the closing of such transaction.

The new subsidiary shall enter an employment agreement with each key employee of CoroWare. In addition, in the first twelve month period following closing, such key employees shall be eligible for a compensation bonus, based on

sales of not less than \$1,900,000.

The Company's obligation to purchase the assets set forth in the Agreement is subject to a satisfactory due diligence review. If the Company does not notify CoroWare on or prior to April 30, 2006 that it is not satisfied with the results of the due diligence review, this requirement will be deemed met. For purposes of the Agreement, the Company will be deemed satisfied with the due diligence review if (a) audited financial statements to be delivered by CoroWare are not materially different from the unaudited financial information previously provided to the Company by CoroWare; and (b) all other information relating to the business assets of CoroWare does not differ materially from the information provided to the Company by CoroWare prior to the date of the Agreement.

The obligations under the Agreement terminate in the event that (a) a definitive written agreement is not executed by April 30, 2006; (b) the transaction contemplated by the Agreement has not closed by May 31, 2006; or (c) there is a material adverse change in the business of either the Company or CoroWare.

The determination of the consideration to be paid in the transaction was determined in arms length negotiations between the Boards of Directors of the Company and CoroWare. The negotiations took into account the value of the assets sold to the Company and the consideration paid. At the time of the transaction, there were no material relationships between CoroWare and the Company, or any of its affiliates, any director or officer of the Company, or any associate of any such officer or director.

#### **Stock Options:**

Compensation costs of \$530,021 were recognized during the first quarter of 2006 for grants under the stock option plans as a result of the Company implementing SFAS 123(R) effective January 1, 2006. Under the modified prospective method, the Company recognizes compensation expense at previously determined fair values for all unvested awards granted to employees prior to the effective date of adoption and fair value for all new share-based payments made after adoption.

During the first quarter of 2006 there were 20,000,000 options granted to directors and 13,000,000 options granted to employees. The share purchase options granted to directors vested upon the award and for employees the options vest evenly over a three year period from date of grant. All options granted in the first quarter are exercisable at \$.01 per share and they expire ten years after the grant date.

In March 2006 the Company modified 18,000,000 options granted to the Chief Financial Officer in 2005 by changing their vesting from a three year period to 100% vested as of December 14, 2005 and by changing the exercise price from \$.036 to \$.01. Additionally, 12,121,276 options that were granted in December 2004 to Stratex Solutions, LLC, the business owned by the Chief Financial Officer before he became an employee of the Company, with an exercise price of \$.005 per share and vesting monthly over five years were changed to vest over three years. And the Company modified 15,000,000 options granted to the Chief Executive Officer and 5,658,621 options granted to an employee in 2005 by changing the exercise price from \$.017 per share to \$.01 per share.

The Board of Directors of the Company approved all of the stock options awarded and modified.

For new share-based payments made after adoption of SFAS 123(R), the Company has estimated fair value at the date of grant using the Flexible Binomial Model, which includes a volatility assumption of 44.19%, a risk-free rate of 2.45% and the related term of the share-based payments ranging from immediate to five years. In determining fair value of share-based payments as of March 31, 2006, management has estimated a forfeiture rate of 5%.

The following table summarizes stock option activity:

|                                |             |
|--------------------------------|-------------|
| Outstanding, December 31, 2005 | 103,107,400 |
|--------------------------------|-------------|

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|   |             |
|---|-------------|
| Granted   | 33,000,000  |
| Cancelled   | -           |
| Exercised   | -           |
| Outstanding, March 31, 2006                             | 136,107,400 |
| Weighted-average grant-date fair<br>value of options    | \$ 0.01     |
| Weighted-average remaining years<br>of contractual life | 9.1         |

#### NOTE 4 - NOTES PAYABLE AND LONG TERM DEBT

On June 14, 2005 the Company entered into a Standby Equity Distribution Agreement discussed in Note 3 above. In connection with this agreement, the Company issued a \$300,000 promissory note to Cornell Capital partner, the major terms of which are as follows:

-the Company shall repay the Promissory Note in three equal principal payments of One Hundred Thousand Dollars (\$100,000) each on the 30th, 60th and 90th days following the date Securities and Exchange Commission declares that a registration statement filed by the Company in connection with the Standby Equity Distribution Agreement is effective, which was December 22, 2005.

-this Promissory Note shall not bear interest unless and until there is an event of default.

-at the option of Cornell Capital Partners, all sums advanced under the promissory note shall become immediately due and payable, without notice or demand, upon the occurrence of any one or more of the following events of default: (a) the Company's failure to pay in full any payment of principal within 5 days of the date when such payment of principal becomes due; (b) the commencement of any proceedings under any bankruptcy or insolvency laws, by or against the Company; or (c) the registration statement is not declared effective within one hundred eighty (180) days of the date hereof, unless such failure to obtain effectiveness is solely due to reasons related to the transactions described in the Company's April 29, 2003 8-K.

-any payment of principal which is not paid within 5 days of the date such payment becomes due, shall bear interest at the rate of twelve (12) percent per annum commencing on the date immediately following the day upon which the payment was due. Upon the occurrence of any event of default as defined above, all sums outstanding shall thereupon immediately bear interest at the rate of twelve (12) percent per annum.

The promissory note of \$300,000 issued to Cornell has been recorded as a note payable and as deferred financing costs. Also, the Company received a waiver from Cornell delaying the payment of the amounts due to no later than December 31, 2006. During the three months ended March 31, 2006 \$20,000 of the promissory note was repaid.

On October 7, 2005, the Company entered into a Securities Purchase Agreement with Cornell Capital Partners, LP ("Cornell Capital"). Pursuant to this Agreement, the Company sold a Convertible Debenture in the principal amount of \$55,000 to Cornell Capital. The Convertible Debenture bears interest at the rate of 12% per annum and is due on April 7, 2006. The Company will pay directly to Cornell Capital all revenues it receives until the principal amount and all accrued interest on the Convertible Debenture has been paid in full. The principal of the Convertible Debenture is convertible into common stock of the Company at a price of \$.03 per share (the "Conversion Shares"). In the event of default by the Company, the principal of the Convertible Debenture is convertible into Conversion Shares at a price of \$.005 per share. The Company granted demand registration rights to Cornell Capital for the Conversion Shares. The Convertible Debenture is secured by a second lien on all of the assets of the Company. During the quarter ended March 31, 2006, \$30,000 of the convertible debentures was repaid to Cornell Capital.

As further discussed under Derivative Liability below, the entire proceeds from the Cornell Capital Convertible Debenture were allocated to a derivative liability, which is being carried at fair value. The resulting discount on the host instrument is being amortized over the term of the instrument using the effective interest method. Amortization of debt discount during the three months ended March 31, 2006 amounted to \$52,471.

During September through December 2005 the Company entered into short-term debt obligations other than in the ordinary course of business totaling \$257,000. All of this short-term debt bears interest at the rate of 10% per annum and is due between ninety and one hundred twenty days. All of the lenders are shareholders of the Company, including the Chief Financial Officer who loaned the Company \$45,000 and a Director who loaned the Company \$1,000. All lenders agreed to extend the due date to December 31, 2006. During the first quarter ended March 2006, \$25,000 was repaid to a shareholder.

#### Derivative Financial Instruments:

The Company accounts for all derivative financial instruments in accordance with SFAS No. 133. Derivative financial instruments are recorded as liabilities in the consolidated balance sheet, measured at fair value. When available, quoted market prices are used in determining fair value. However, if quoted market prices are not available, the Company estimates fair value using either quoted market prices of financial instruments with similar characteristics or other valuation techniques.

The value of the derivative liabilities relating to the credit facilities in the quarterly financial statements are subject to the changes in the trading value of the Company's common stock and other assumptions. As a result the Company's quarterly financial statements may fluctuate from quarter to quarter based on factors such as trading value of the Company's Common Stock. Consequently, our consolidated financial position and results of operations may vary from quarter to quarter based on conditions other than the Company's operating revenue and expenses. See below regarding valuation methods used for derivative financial instruments.

The balance sheet account entitled "Derivative liability" consists of the combined fair value of the conversion and certain other features that were embedded in the Cornell Debenture, referred to above. These features were compounded into one instrument and bifurcated from the debt instrument upon issuance of the debenture in accordance with Financial Accounting Standard No. 133, Derivative Financial Instruments (FAS133). On the date of issuance, the fair value of the compound derivative financial instrument amounted to \$163,240, which exceeded the proceeds by (\$108,240). In accordance with FAS133, the excess was immediately charged to expense. During the period from issuance to December 31, 2005, the fair value of the derivative declined in value by \$118,932. In accordance with FAS133, this amount was credited to income during the period. During the first quarter 2006, the fair value of the derivative declined in value by \$12,508. In accordance with FAS133, this amount was credited to income during the period. The residual derivative liability associated with the debenture balance that was repaid, amounting to \$26,500, was credited to Additional Paid in Capital. The derivative financial instrument will continue to be adjusted to fair value until the debenture is settled. On March 31, 2006, the derivative financial instrument was indexed to 5,300,000 shares of the Company's common stock.

The Company utilizes the Monte Carlo valuation model to value its complex financial instruments because this methodology provides for all of the necessary assumptions necessary for fair value determination, including assumptions for credit risk, interest risk and conversion/redemption behavior. Significant assumptions underlying this methodology are: Effective Term—remaining term of the host instrument; Effective Volatility—44.19%; Effective Risk Adjusted Yield—12.36%.

#### **NOTE 5 - SUBSEQUENT EVENTS**



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Since March 31, 2006, the Company utilized the SEDA discussed in Note 3 and sold 50,726,706 shares of common stock to Cornell Capital for gross proceeds of \$850,000. Of the gross proceeds received, Cornell was paid \$42,500 in commitment fees and \$2,500 in structuring fees. Additionally, \$80,000 of the promissory note due Cornell and discussed in Note 4 was paid.

Additionally, the remaining amounts owed Cornell Capital regarding the convertible debentures borrowed from Cornell Capital, as discussed in Note 4, were repaid after March 31, 2006; these amounts totaled \$27,946 and represented principal and accrued interest.

In April 2006, 1,333,000 options were granted to an independent contractor at an exercise price of \$.017 per share and a term of three years with complete vesting by December 31, 2006. Also in April 2006, 11,500,000 options were granted to an independent contractor at an exercise price of \$.013 per share and a term of three years; vesting is one third at the end of each calendar year ending December 31, 2008.

#### **NOTE 6 - RESTATEMENT OF PREVIOUSLY REPORTED FINANCIAL STATEMENTS**

There was a misstatement in the originally prepared March 31, 2005 financial statements which related to the beneficial conversion features of the \$125,000 of Mandatorily Redeemable Series A Preferred Stock issued in June 2004 and assumed by the Company as part of the reverse merger in August 2004, and the \$525,000 Series B Preferred Stock issued between September 2004 and March 2005. Management calculated the value of the beneficial conversion features and determined it was \$50,000 for the Series A Preferred Stock at the date of issuance. Of this amount, \$48,300 was the amount of the assumed unamortized beneficial conversion feature, of which \$3,600 was amortized to Accumulated Deficit during 2004 and \$2,500 was amortized to Accumulated Deficit during the three months ended March 31, 2005. The beneficial conversion feature was \$146,500 for the Series B Preferred Stock sold in 2004 and \$141,500 for the Series B Preferred Stock sold during the three months ended March 31, 2005. Accordingly, the Statement of Operations for the three months ended March 31, 2005 was restated to reflect the amount of the beneficial conversion features.

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

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

### **BACKGROUND**

We were formed in 1992 as a supplier to the information technology business. On January 31, 2003, we completed a reverse acquisition into SRM Networks, an Internet service provider, in which we were deemed the "accounting acquirer". We discontinued SRM Network's Internet business. In connection with the transaction, SRM Networks, Inc. changed its name to Hy-Tech Technology Group, Inc.

On August 25, 2004, we completed a reverse merger into Robotic Workspace Technologies, Inc. ("RWT"), a robotics software technology provider, in which RWT was deemed the "accounting acquirer." Simultaneously, we sold our Hy-Tech Computer Systems, Inc. subsidiary and discontinued our computer systems sales and services business. In connection with these transactions, Hy-Tech Technology Group, Inc. changed its name to Innova Holdings, Inc.

### **CRITICAL ACCOUNTING POLICIES**

#### General

The consolidated financial statements and notes included in this Form 10-QSB contain information that is pertinent to this management's discussion and analysis. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company to make estimates and assumptions that affect the reported amounts of its assets and liabilities, and affect the disclosure of any contingent assets and liabilities. The Company believes these accounting policies involve judgment due to the sensitivity of the methods, assumptions, and estimates necessary in determining the related asset and liability amounts. The significant accounting policies are described in its financial statements and notes included in its Form 10-KSB filed with the Securities and Exchange Commission.

#### Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectibility is probable. Product sales are recognized by the Company generally at the time product is shipped. Shipping and handling costs are included in cost of goods sold.

The Company accounts for arrangements that contain multiple elements in accordance with EITF 00-21, "Revenue Arrangements with Multiple Deliverables". When elements such as hardware, software and consulting services are contained in a single arrangement, or in related arrangements with the same customer, the Company allocates revenue to each element based on its relative fair value, provided that such element meets the criteria for treatment as a separate unit of accounting. The price charged when the element is sold separately generally determines fair value. In

the absence of fair value for a delivered element, the Company allocates revenue first to the fair value of the underlying elements and allocates the residual revenue to the delivered elements. In the absence of fair value for an undelivered element, the arrangement is accounted for as a single unit of accounting, resulting in a delay of revenue recognition for the delivered elements until the undelivered elements are fulfilled. The Company limits the amount of revenue recognition for delivered elements to the amount that is not contingent on future delivery of products or services or subject to customer-specified return of refund privileges.

### Accounting for Stock-Based Compensation

In accordance with SFAS 123(R), the Company has implemented the modified prospective method which recognizes compensation expense at previously determined fair values for all unvested awards granted to employees prior to the effective date of adoption and fair value for all new share-based payments made after adoption. The effect on net loss related to the adoption of FAS 123(R) was \$358,271.

### Allowance for Doubtful Accounts

Earnings are charged with a provision for doubtful accounts based on past experience, current factors, and management's judgment about collectibility. Accounts deemed uncollectible are applied against the allowance for doubtful accounts.

### Derivative Financial Instruments

The Company accounts for all derivative financial instruments in accordance with SFAS No. 133. Derivative financial instruments are recorded as liabilities in the consolidated balance sheet, measured at fair value. When available, quoted market prices are used in determining fair value. However, if quoted market prices are not available, the Company estimates fair value using either quoted market prices of financial instruments with similar characteristics or other valuation techniques.

The value of the derivative liabilities relating to the credit facilities in the quarterly financial statements are subject to the changes in the trading value of the Company's common stock and other assumptions. As a result the Company's quarterly financial statements may fluctuate from quarter to quarter based on factors such as trading value of the Company's common stock. Consequently, our consolidated financial position and results of operations may vary from quarter to quarter based on conditions other than the Company's operating revenue and expenses. See Note 4 regarding valuation methods used for derivative liabilities.

## **RESULTS OF OPERATIONS**

### **THREE MONTHS ENDED MARCH 31, 2006 COMPARED TO THREE MONTHS ENDED MARCH 31, 2005:**

During the three month period ended March 31, 2006 (the "2006 Period") revenues were \$136,490 compared to revenues of \$0 during the three month period ended March 31, 2005 (the "2005 Period"). These 2006 revenues resulted from the shipment of part of a multiple order for the Universal Robotic Controller produced by Robotic Workspace Technologies, Inc., a wholly owned subsidiary of Innova Holdings, Inc. Gross profit on these revenues amounted to \$28,800. The remainder of the order was shipped in April.

Costs of goods sold represent primarily materials to assemble the Universal Robot Controllers, including electronic parts and components, electrical amplifiers, cabinetry to house all of the materials, warranty costs and teach pendants. Additionally, labor to assemble the controllers and install software is included.

Operating expenses were \$1,044,357 during the 2006 period compared to \$533,532 during the 2005 Period. The increase in operating expenses primarily resulted from increased stock based compensation of \$530,021, which resulted from the implementation of SFAS 123(R) as discussed in Note 2. All other operating expenses amounted to \$514,336 during the 2006 Period compared to \$533,532 during the 2005 Period, and represented mostly compensation costs, trade shows and other sales expenses, travel expenses, rental expense and related office expenses. The Company did not incur any significant R&D expenditures this quarter.



Net loss for the 2006 Period was \$1,116,331 compared to a net loss of \$557,069 for the 2005 Period, due largely to increased stock based compensation of \$530,021, which resulted from the implementation of SFAF 123(R) as discussed above and in Note 2.

## **LIQUIDITY AND CAPITAL RESOURCES**

At March 31, 2006, we had current assets of \$107,446 and current liabilities of \$3,398,297. At March 31, 2006, we had negative working capital of \$3,290,851 and an accumulated deficit of \$10,624,471.

As described in Note 3, on June 14, 2005, Innova entered into a Standby Equity Distribution Agreement (SEDA) with Cornell Capital Partners. Under the SEDA, Innova may issue and sell to Cornell Capital Partners common stock for a total purchase price of up to \$10,000,000 over a twenty four month period, commencing on the date a registration statement filed with the U.S. Securities and Exchange Commission. On December 22, 2005 the registration statement became effective. Starting in January 2006, the Company began to raise capital through the use of the SEDA. During the first quarter 2006, \$595,000 net proceeds were received by the Company and since March 31, 2006 another \$803,100 of net proceeds were received by the Company. Of these amounts, \$20,000 and \$80,000 respectively, were used to repay the Cornell promissory note discussed in Note 4. Management believes the use of the SEDA will provide the Company with sufficient working capital through the remainder of the SEDA commitment period, which expires in December 2007. Additionally, \$100,650 was received from investors through a private placement. The Company will continue to seek funds through private placements as well as debt financing. The Company will also continue to investigate alternative sources of financing.

We cannot guarantee that additional funding will be available on favorable terms, if at all. If we are unable to obtain debt and/or equity financing upon terms that our management deems sufficiently favorable, or at all, it would have a materially adverse impact upon our ability to pursue our business strategy and maintain our current 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.

## **EFFECT OF RECENT ACCOUNTING PRONOUNCEMENTS**

Stock-Based Compensation. Effective January 1, 2006 we adopted SFAS 123R and our consolidated financial statements as of and for the three months ended March 31, 2006 reflect the impact of SFAS 123R. For the three months ended March 31, 2006, we recorded stock-based compensation expense of \$530,021. The impact on basic net loss per share for the three months ended March 31, 2006 was \$0.00. For the three months ended March 31, 2005, we recognized \$0 of stock-based compensation expense under the intrinsic value method in accordance with APB 25. See Note 2—"Stock-Based Compensation" of the consolidated financial statements for further information.

### **ITEM 3. CONTROLS AND PROCEDURES**

a) Evaluation of Disclosure Controls and Procedures. As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Exchange Act). Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms.

(b) Changes in internal controls. There was no change in our internal controls or in other factors that could affect these controls during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

None

### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

In January 2006, the Company obtained \$70,000 of funds through the private placement sale of 9,589,042 shares of the Company's common stock at \$.0073 per share, and an additional \$25,650 of funds through the private placement sale of 1,500,000 shares of the Company's common stock at \$.0171 per share. In February 2006 an additional \$5,000 of funds were obtained through the private placement sale of 505,051 shares of the Company's common stock at \$.0099 per share.

During the first quarter of 2006 there were 20,000,000 options granted to directors and 13,000,000 options granted to employees. The share purchase options granted to directors vested upon the award and for employees the options vest evenly over a three year period from date of grant. All options granted in the first quarter are exercisable at \$.01 per share and they expire ten years after the grant date. The options had a fair value of \$210,833 on the grant date.

On March 10, 2006 the Chief Financial Officer received a bonus of 5,625,000 shares of the Company's common stock which was valued at \$50,000 based on \$.009 per share, the closing price of the Company stock on March 9, 2006.

During the quarter ended March 31, 2006, the remaining \$81,450 shares of the Series A preferred stock were converted into 16,290,000 shares of the Company's common stock, and dividends were converted into 112,168 shares of the Company's common stock.

The issuance of the aforementioned securities was exempt from registration requirements of the Securities Act of 1933 pursuant to Section 4(2) of such Securities Act and Regulation D promulgated thereunder based upon the representations of each of the purchasers that it was an "accredited investor" (as defined under Rule 501 of Regulation D) and that it was purchasing such securities without a present view toward a distribution of the securities. In addition, there was no general advertisement conducted in connection with the sale of the securities.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

In February 2003 the Company issued \$230,000 of notes payable, which were due in June 2003. These notes have not been repaid and have been in default since 2003. The notes earn interest at 8% unless they are in default, in which case



they earn interest at 15%; since the notes are currently in default they earn interest at 15%.

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**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

(a) Exhibits

31.1 Certification by Chief Executive Officer pursuant to Sarbanes Oxley Section 302.

31.2 Certification by Chief Financial Officer pursuant to Sarbanes Oxley Section 302.

32.1 Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350

32.2 Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on this 15<sup>th</sup> day of May 2006.

**INNOVA HOLDINGS, INC.**

*/s/ Walter K. Weisel*

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*Walter K. Weisel*  
*Chief Executive Officer (Principal Executive Officer)*

*/s/ Eugene V. Gartlan*

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*Eugene V. Gartlan*  
*Chief Financial Officer (Principal Accounting and*  
*Financial Officer)*