

**TANK SPORTS, INC. AND SUBSIDIARIES**

**CONSOLIDATED FINANCIAL STATEMENTS AND COMPILATION REPORT OF  
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**FEBRUARY 28, 2009**

**TANK SPORTS, INC. AND SUBSIDIARIES**  
**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FEBRUARY 28, 2009**

Compilation Report of Independent Registered Public Accounting Firm – KCCW Accountancy Corp.....	1
Report of Independent Registered Public Accounting Firm – Kabani & Company, Inc.....	2
Financial Statements:	
Consolidated Balance Sheets.....	3
Consolidated Statements of Operations.....	4
Consolidated Statements of Changes in Deficit.....	5
Consolidated Statements of Cash Flows.....	6
Notes to Unaudited Consolidated Financial Statements.....	8

**COMPILATION REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of  
Tank Sports, Inc. and Subsidiaries:

We have compiled the accompanying balance sheet of Tank Sports, Inc. and Subsidiaries as of February 28, 2009, and the related statement of operations, changes in deficit, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The financial statements of Tank Sports, Inc. and Subsidiaries for the year ended February 29, 2008 were audited by the predecessor auditor whose report, dated May 27, 2008, expressed an unqualified opinion on those statements, with an explanatory paragraph of substantial doubt about the Company's ability to continue as a going concern.

A Compilation is limited to presenting in the form of financial statements information that is the representation of management. We have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

The Company has accumulated deficit of \$9,464,690 as of February 28, 2009, including a net loss of \$2,675,980 during the year ended February 28, 2009. These factors as discussed in Note 2 to the financial statements raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.



KCCW Accountancy Corp.

Diamond Bar, California  
May 25, 2009

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders  
Tank Sports, Inc. and subsidiary

We have audited the accompanying balance sheet of Tank Sports, Inc. (the Company) and its subsidiaries as of February 29, 2008 and the related consolidated statements of operations, stockholders' deficit, and cash flows for the year in the period ended February 29, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Tank Sports Inc. and its subsidiary, as of February 29, 2008, and the results of its operations and its cash flows for each of the two years ended February 29, 2008, in conformity with accounting principles generally accepted in the United States of America. The Company's financial statements are prepared using the generally accepted accounting principles applicable to a going concern, which contemplates the realization of assets and liquidation of liabilities in the normal course of business.

The Company has accumulated deficit of \$6,788,710 as of February 29, 2008 including a net loss of \$5,744,719 during the year ended February 29, 2008. These factors as discussed in Note 2 to the financial statements, raises substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

KABANI & COMPANY, INC.  
CERTIFIED PUBLIC ACCOUNTANTS  
Los Angeles, California  
May 27, 2008\*

- \* (1) The report is a copy of the previously issued report.
- (2) The predecessor auditor has not reissued the report.

**TANK SPORTS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

	<u>February 28,</u> <b>2009</b>	<u>February 29,</u> <b>2008</b>
	<b>(Unaudited)</b>	<b>(Audited)</b>
<b><u>ASSETS</u></b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 401,998	\$ 2,889,820
Accounts receivable, net	513,967	134,863
Prepaid expenses and other current assets	92,131	68,184
Purchase advances	722,196	276,380
Due from related parties	2,263,396	2,910,379
Inventory	2,872,939	3,999,891
Assets from discontinued operations	-	215,579
<b>Total Current Assets</b>	<b>6,866,626</b>	<b>10,495,096</b>
<b>PROPERTY, PLANT AND EQUIPMENT, NET</b>	1,541,348	1,929,197
<b>DEPOSIT</b>	25,616	25,616
<b>INVESTMENT IN EQUITY</b>	34,995	55,096
<b>INTANGIBLE ASSETS</b>		
Trademark, net	2,731	2,812
Licenses and permits	1,160,753	1,184,090
Land right, net	3,943,782	3,870,978
Goodwill	1,178,492	1,178,492
<b>Total Intangible Assets</b>	<b>6,285,758</b>	<b>6,236,372</b>
<b>TOTAL ASSETS</b>	<b>\$ 14,754,342</b>	<b>\$ 18,741,377</b>
<b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued expenses	\$ 3,047,343	\$ 2,610,576
Notes payable	1,500,000	2,000,740
Loans Payable	5,736,934	7,949,633
Customer deposits	97,973	162,578
Other payable	1,359,995	131,385
Due to related parties	4,455,800	4,749,163
Shares to be issued	-	1,520,000
Liabilities from discontinued operations	-	76,300
<b>Total Current Liabilities</b>	<b>16,198,045</b>	<b>19,200,375</b>
<b>LONG-TERM LIABILITIES</b>		
Loans payable	158,672	203,067
<b>DEFICIT</b>		
<b>Stockholders' Deficit</b>		
Common stock (\$0.001 par value, 200,000,000 shares authorized, 40,197,445 and 38,636,214 shares issued, 40,197,445 and 38,527,596 outstanding)	40,197	38,636
Additional paid in capital	7,191,419	5,823,688
Accumulated deficit	(9,464,690)	(6,788,710)
Other comprehensive income	558,690	282,039
Treasury stock, at cost (0 and 108,618 shares)	-	(114,049)
<b>Total Stockholders' Deficit</b>	<b>(1,674,383)</b>	<b>(758,396)</b>
<b>Noncontrolling Interest</b>	<b>72,009</b>	<b>96,331</b>
<b>Total Deficit</b>	<b>(1,602,374)</b>	<b>(662,065)</b>
<b>TOTAL LIABILITIES AND DEFICIT</b>	<b>\$ 14,754,343</b>	<b>\$ 18,741,377</b>

See Accountant's Compilation Report.

**TANK SPORTS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**

	<b>For Year Ended February 28, 2009</b>	<b>For Year Ended February 29, 2008</b>
	<b>(Unaudited)</b>	<b>(Audited)</b>
<b>REVENUE, NET</b>	\$ 11,412,047	\$ 11,610,750
<b>COST OF GOODS SOLD</b>	10,038,680	9,601,274
Gross profit	1,373,367	2,009,475
<b>OPERATING EXPENSES:</b>		
Selling expenses	809,718	1,084,024
Goodwill impairment		1,615,716
General and administrative expenses	2,773,989	3,892,034
Total operating expenses	3,583,706	6,591,774
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>	(2,210,339)	(4,582,299)
<b>NON-OPERATING INCOME (EXPENSES)</b>		
Other income (expense)	336,418	(66,404)
Other expense	(9,414)	-
Loss on investment in equity	(26,115)	(5,436)
Interest income	54,203	47,747
Interest expenses	(700,002)	(402,867)
Total non-operating income (expense)	(344,910)	(426,960)
<b>LOSS FROM CONTINUING OPERATIONS, BEFORE TAX</b>	(2,555,249)	(5,009,259)
<b>PROVISION FOR INCOME TAX</b>	800	800
<b>LOSS FROM CONTINUING OPERATIONS, NET OF TAX</b>	(2,556,049)	(5,010,059)
<b>LOSS FROM DISCONTINUED OPERATIONS</b>	(144,253)	(745,605)
<b>NET LOSS</b>	(2,700,302)	(5,755,664)
<b>NET LOSS ATTRIBUTABLE TO NONCONTROLLING INTEREST</b>	24,322	10,945
<b>NET LOSS ATTRIBUTABLE TO COMMON STOCKHOLDERS</b>	\$ (2,675,980)	\$ (5,744,719)
<b>EARNINGS PER SHARE - BASIC AND DILUTED</b>		
Loss from continuing operations attributable to common stockholders	\$ (0.06)	\$ (0.14)
Loss from discontinued operations attributable to common stockholders	(0.01)	(0.02)
Net loss attributable to common stockholders	\$ (0.07)	\$ (0.16)
<b>WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING, BASIC AND DILUTED</b>	39,831,035	36,355,413
<b>AMOUNTS ATTRIBUTABLE TO COMMON STOCKHOLDERS</b>		
Loss from continuing operations, net of tax	\$ (2,531,727)	\$ (4,999,114)
Loss from discontinued operations	(144,253)	(745,605)
Net loss	\$ (2,675,980)	\$ (5,744,719)

See Accountant's Compilation Report.

**TANK SPORTS, INC. AND SUBSIDIARIES**  
**STATEMENTS OF DEFICIT**

	Common Stock		Common Stockholders			Other Comprehensive Income	Total Stockholders' Deficit	Noncontrolling Interest	Total Deficit
	Number of shares	Amount	Additional Paid in Capital	Accumulated Deficit	Treasury Stock				
<b>Balance at February 28, 2007 (Audited)</b>	32,902,800	32,903	558,797	(1,043,992)	-	-	(452,292)	-	(452,292)
Stock issuance for cash	2,107,000	2,107	1,011,926	-	-	-	1,014,033	-	1,014,033
Shares issued for cash received in last year	1,144,500	1,145	1,088,856	-	-	-	1,090,000	-	1,090,000
Stock issuance for employee compensation	81,914	82	68,799	-	-	-	68,881	-	68,881
Stock issuance for PMI Acquisition	2,400,000	2,400	2,277,600	-	-	-	2,280,000	107,276	2,387,276
Warrants issuance for PMI acquisition	-	-	883,661	-	-	-	883,661	-	883,661
Cash paid for shares price adjustment issued for debt settlement	-	-	(65,951)	-	-	-	(65,951)	-	(65,951)
Repurchase of treasury stock	(108,618)	-	-	-	(114,049)	-	(114,049)	-	(114,049)
Foreign exchange gain	-	-	-	-	-	282,039	282,039	-	282,039
Net loss for the year ended February 29, 2008	-	-	-	(5,744,719)	-	-	(5,744,719)	(10,945)	(5,755,664)
<b>Balance at February 29, 2008 (Audited)</b>	<u>38,527,596</u>	<u>\$ 38,636</u>	<u>\$ 5,823,688</u>	<u>\$ (6,788,711)</u>	<u>\$ (114,049)</u>	<u>\$ 282,039</u>	<u>\$ (758,396)</u>	<u>\$ 96,331</u>	<u>\$ (662,064)</u>
Repurchase of treasury stock	(130,151)	-	-	-	(136,659)	-	(136,659)	-	(136,659)
Cancellation of treasury stock	-	(240)	(250,469)	-	250,708	-	-	-	-
Shares issued for completion of PMI Acquisition	1,600,000	1,600	1,518,400	-	-	-	1,520,000	-	1,520,000
Shares issued for debt settlement	200,000	200	99,800	-	-	-	100,000	-	100,000
Foreign exchange gain	-	-	-	-	-	276,651	276,651	-	276,652
Net loss for the year ended February 28, 2009	-	-	-	(2,675,980)	-	-	(2,675,980)	(24,322)	(2,700,302)
<b>Balance at February 28, 2009 (Unaudited)</b>	<u>40,197,445</u>	<u>\$ 40,197</u>	<u>\$ 7,191,419</u>	<u>\$ (9,464,690)</u>	<u>\$ -</u>	<u>\$ 558,690</u>	<u>\$ (1,674,383)</u>	<u>\$ 72,009</u>	<u>\$ (1,602,373)</u>

See Accountant's Compilation Report.

**TANK SPORTS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>For The Year Ended</b>	
	<b>February 28,</b>	<b>February 29,</b>
	<b>2009</b>	<b>2008</b>
	<b>(Unaudited)</b>	<b>(Audited)</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss	\$ (2,675,980)	\$ (5,744,719)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	398,742	223,894
Loss on investment in equity	20,102	-
Loss on disposal of fixed assets	10,706	5,436
Loss on disposal of discontinued operations	50,344	-
Gain from settlement of debt	(89,855)	-
Minority interest	(24,322)	(10,945)
Goodwill impairment	-	1,615,716
Common stock issued for employee compensation	-	68,881
Bad debt	-	144,607
Changes in current assets and liabilities:		
Accounts receivable	(379,104)	162,328
Prepaid expenses and other current assets	(33,446)	136,927
Related party receivable	57,157	-
Loan receivable	-	251,240
Inventory	1,126,952	(940,419)
Purchase advance	(445,816)	(915,925)
Deposits	-	25,854
Accounts payable and accrued expenses	436,767	(1,210,307)
Other payable	1,228,610	-
Tax payable	-	(16,502)
Customer deposit	(64,605)	(83,951)
<b>Net cash provided by continuing operations</b>	<b>(383,749)</b>	<b>(6,287,885)</b>
<b>Net cash provided by discontinued operations</b>	<b>139,279</b>	<b>802,344</b>
<b>Net cash provided by operating activities</b>	<b>(244,470)</b>	<b>(5,485,541)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from disposal of property and equipment	68,974	-
Payment on purchase of property and equipment	-	(80,621)
Cash acquired from PMI	-	170,725
Purchase of trade mark	-	(3,056)
Purchase of intangible assets	-	(50,906)
Purchase of land use rights	-	(200,218)
Due from related parties	-	(1,702,852)
<b>Net cash used in continuing operations</b>	<b>68,974</b>	<b>(1,866,928)</b>
<b>Net cash provided by discontinued operations</b>	<b>-</b>	<b>-</b>
<b>Net cash used in investing activities</b>	<b>68,974</b>	<b>(1,866,928)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net (repayments) proceeds of loans from bank	(2,212,699)	7,949,633
Repayments of notes payable	(355,280)	(3,014,460)
Net proceeds of loans from related parties	649,827	1,316,611
Repurchase of treasury stock	(136,659)	(114,049)
Net repayments of loans from related parties	(353,363)	-
Cash payment for shortfall on common stock issued for debt settlement	-	(65,951)
Issuance of common stocks for cash	-	1,014,033
<b>Net cash provided by (used in) continuing operations</b>	<b>(2,408,174)</b>	<b>7,085,817</b>
<b>Net cash provided by discontinued operations</b>	<b>-</b>	<b>-</b>
<b>Net cash provided by (used in) financing activities</b>	<b>(2,408,174)</b>	<b>7,085,817</b>

(Continued)

See Accountant's Compilation Report.

**TANK SPORTS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)**

	<b>For The Year Ended</b>	
	<b>February 28,</b>	<b>February 29,</b>
	<b>2009</b>	<b>2008</b>
	<b>(Unaudited)</b>	<b>(Audited)</b>
<b>EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALANTS</b>	95,848	279,557
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(2,583,670)	12,905
<b>CASH AND CASH EQUIVALENTS, BEGINNING BALANCE</b>	2,889,820	2,876,915
<b>CASH AND CASH EQUIVALENTS, ENDING BALANCE</b>	\$ 401,998	\$ 2,889,820
<b>SUPPLEMENTAL DISCLOSURES:</b>		
Interest paid	\$ 700,002	\$ 335,242
Income tax paid	\$ 800	\$ 800
<b>SUPPLEMENTAL DISCLOSURES FOR NON CASH INVESTING AND FINANCING ACTIVITIES</b>		
Shares and warrants issued for acquisition of PMI	\$ -	\$ 3,163,661
Share to be issued for acquisition of PMI	\$ -	\$ 1,520,000
Share issued for cash received in last period	\$ -	\$ 1,090,000
Payable from additional cost of acquisition of PMI	\$ -	\$ 189,855
Shares issued for acquisition of PMI completed in prior year	\$ 1,520,000	\$ -
Shares issued for settlement of debt	\$ 100,000	\$ -

See Accountant's Compilation Report.

# **TANK SPORTS, INC. AND SUBSIDIARY**

## **NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

### **1. ORGANIZATION AND DESCRIPTION OF BUSINESS**

#### **Corporate History**

Tank Sports, Inc. (the “Company”, or the “Group”) was originally incorporated under the laws of the State of California on March 5, 2001, as Bi-Tank, Inc. On June 21, 2004, the Company changed its name to Tank Sports, Inc. and its principal place of business is located at 10925 Schmidt Road, El Monte, California 91733.

On January 30, 2007, the Company acquired Lowprice.com, Inc. an Arizona corporation d/b/a Redcat Motors (“Redcat”) as it’s wholly owned subsidiary. Redcat is engaged in the distribution of motorcycles and ATVs under the Redcat brand name in the United States through its dealer network.

On November 15, 2007, the Company acquired 100% stock of People’s Motor International Co., Ltd. (“PMI”) and its subsidiaries. PMI was incorporated in the British Virgin Islands on March 13, 2001 and has manufacturing plant in Shanghai to produce dune buggies and a distribution company in Hong Kong to market the products to international markets including the United States under the “Dazon” brand name. With these two acquisitions the Company has enhanced its distribution network in the U.S., Europe and other international markets as well as obtained proprietary technologies in dune buggy production and related product development abilities.

#### **Current Business Operations**

Tank Sports markets, sells and distributes recreational and transportation motorcycles, all-terrain vehicles (“ATVs”), dirt bikes, scooters and dune buggies in the United States and international markets. The Company supports each product line with an assortment of replacement parts and accessories, which are available at the Company’s dealerships and websites. Our products are distributed through a sales net work of about 900 dealers, indirect and distributors worldwide, of which about 543 dealers are in the United States. Outside the U.S., the Company sells its products through an international network of dealers and distributors in countries like the United Kingdom, France, Holland, Spain, Italy, Austria, Australia, South Africa, Mexico, Ecuador, Mexico, Canada and Jamaica.

The Company offers three models of cruiser motorcycles, fourteen models of dirt bike motorcycles and all-terrain vehicles, eight models of scooters and four models of dune buggies. The engine displacements of the motorcycles range from 50cc to 250cc, dirt bikes range from 110cc to 350cc, scooters range from 50cc to 150cc, ATVs range form 50cc to 250cc and dune buggies range from 90cc to 1100cc. The Company’s 150cc, 250cc and 1100cc dune buggies have obtained EEC homologation certificate for on road use in EEC countries.

Our products are manufactured in China in our own plant in Shanghai and a designated factory in Guangzhou. Our plant in Shanghai has obtained China Compulsory Certification and is in compliance with ISO 9000 standards regarding its production standard and quality control. The dune buggies are primarily produced in the Shanghai plant and are manufactured according to our proprietary designs and factory standards. The factory in Guangzhou is owned by the principal shareholders of the Company and is primarily the production base for motorcycles, scooters, dirt bikes and ATVs. The quality assurance function of our Company ensures that all the products from the two plants are shipped at the highest possible standards to our customers and backed by timely after sales services. The Company has a warranty program according to industry standards to further support our products.

The Company is currently restructured its pricing structure on non exclusive products to become more competitive in the domestic US market. By lowering the prices we hope to greatly increase our domestic sales volume. At the same time The Company have also signed exclusive distribution rights with Zhejiang Xingyue Mfg Co. A well known supplier of high quality powersports equipment manufacture located in Yongkang China. The new line of vehicles offered under the Tank brand umbrella will feature well built

## **TANK SPORTS, INC. AND SUBSIDIARY**

### **NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

high quality products that sell very well in the high end motorcycle scooter market. The Company expects the joint cooperation with Xingyue to raise the company sales even further.

Since January of 2007, Tank Sports, through the acquisition of RedCat Motors, PMI/Dazon as well as our affiliate manufacturing facility in Guangzhou China and along with the integrated technology of Taiwan's National Motor Co, has implemented the company's new business model. Tank Sports has formed several brand names which include Tank's house brand, Redcat, Dazon and Xi. Guangzhou Tank, in conjunction with Shanghai PMI/Dazon, has increased production capability which now includes many independent products under exclusive intellectual property rights. These products have exceeded the normal standards of Chinese manufacturing capability in our industry. Tank Sports Inc has exclusive rights to distribute these brands in the US market. Tank Sports currently produces 26 vehicle types in 5 market categories which include On-Road motorcycles, Off-Road motorcycles, Scooters, ATVs and GoKart/Buggies. 21 of these models are currently marketed in the United States and Europe. New certifications are in the final stages for 2009 and these include United States EPA, California Air Resources Board (CARB) as well as European Union (EU) certification and should be completed by December which will allow several batches of vehicles to be imported into the United States and the European Union markets.

Tank Sports has discontinued OEM products which were manufactured outside of the Tank controlled manufacturing facilities. Tank Sports will only manufacture and distribute products it has exclusive rights to. Tank Sports also will change its distribution channels to include importers and distributors who will then promote the products to retail stores and chain stores worldwide. In order to further expand the global market, and enrich the product line, the company is proactively seeking strategic investment partners, through an alliance, to develop large markets such as South America, Australia and Africa.

Since June of 2007, the subprime mortgage crisis, and subsequent financial crisis have influenced not only the United States but the entire world. This has created a difficult time for our company to integrate and digest the acquisitions of RedCat Motors in December of 2006 and PMI/Dazon in August of 2007. During this time China produced homogenous products to compete in the market. This reinforced our plan to develop independent products, better parts supply and after-sale technical and customer support. Despite the company's strictly controlled measures to reduce costs and expenses, it still failed to change the first quarter performance which continued to decline and losses continued to increase from March through May. The U.S. entity of the Company reduced the number of employees from 24 to 18 with a goal to further reduce to 14.

The average production per employee is \$1,100,000 of annual revenue. The company analyzed the basic operating cost and found that existing manpower can be configured to produce annual revenues of \$15,000,000. The annual operating expenses could be controlled to a figure of about \$4,000,000 with a monthly cost of approximately \$340,000. For PMI/Dazon Shanghai, the company reduced the employee head count from 148 to 120. On May 15, 2008, the President of PMI/Dazon retired. On April 1, 2008, PMI/Dazon's Finance Vice President resigned, and its Controller resigned on May 15, 2008. The downsizing resulted in a human resources cost decrease of nearly 50%.

## **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### **Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

### **Principles of Consolidation**

The consolidated financial statements for the three months ended August 31, 2008 include the financial statements of the Company, its wholly owned subsidiary Tank (Arizona) and People's Motor International ("PMI International") and PMI International's direct and indirect wholly-owned subsidiaries: Dazon

## **TANK SPORTS, INC. AND SUBSIDIARY**

### **NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

International Co., Ltd. (formerly "PMI Asia", now Dazon International), PMI Import and Export Co., Ltd. ("PMI I&E"), PMI Motorcycle (USA) Co., Ltd. ("PMI USA"), People's Motor (Hong Kong) Co., Ltd. ("PMI Hong Kong"), Dazon Inc., Dazon Arizona Inc., PMI Shanghai Co. Ltd, ("Shanghai Dazon") and its 50% owned subsidiary, PMI Northern Co., Ltd, ("Shanghai Dazon Northern"), from the acquisition date. Additionally, all historical share count and per share information has been adjusted for the Company's 4-for-1 forward stock split that became effective on November 6, 2006.

All significant inter-company transactions and balances have been eliminated on consolidation.

#### **Reclassifications**

Certain comparative amounts have been reclassified to conform to the current period's presentation.

#### **Accounts receivable and other receivable**

Accounts receivable and other receivable are recorded at net realizable value consisting of the carrying amount less an allowance for uncollectible accounts, as needed.

The Company maintains reserves for potential credit losses on accounts receivable. Management reviews the composition of accounts receivable and analyzes historical bad debts, customer concentrations, customer credit worthiness, current economic trends and changes in customer payment patterns to evaluate the adequacy of these reserves. Terms of the sales vary from COD through a credit term up to 10 days and 30 days. Reserves are recorded primarily on a specific identification basis.

#### **Inventories**

Inventories are valued at the lower of cost (determined on a weighted average basis) or market.

#### **Property, Plant and Equipment**

Property, plant and equipment are stated at cost or evaluated market value at the date of acquisition. Expenditures for maintenance and repairs are charged to earnings as incurred; additions, renewals and betterments are capitalized. Straight line method is used to depreciate the assets according to their respective economic useful lives.

#### **Intangible Assets**

The Company evaluates intangible assets for impairment, at least on an annual basis and whenever events or changes in circumstances indicate that the carrying value may not be recoverable from its estimated future cash flows. Recoverability of intangible assets, other long-lived assets and, goodwill is measured by comparing their net book value to the related projected undiscounted cash flows from these assets, considering a number of factors including past operating results, budgets, economic projections, market trends and product development cycles. If the net book value of the asset exceeds the related undiscounted cash flows, the asset is considered impaired, and a second test is performed to measure the amount of impairment loss. There is no impairment on the intangible assets as of February 28, 2009.

#### **Revenue recognition**

The Company's revenue recognition policies are in compliance with Staff Accounting Bulletin (SAB) 104. Sales revenue is recognized when the delivery is completed, the price is fixed or determinable, no other significant obligations of the Company exist and collectability is reasonably assured. Payments received before all of the relevant criteria for revenue recognition are satisfied to be recorded as unearned revenue.

The Company determines title transfer based upon delivery date. For the customers with FOB shipping term, the Company recognizes sales and determines title transferred when delivery of items takes

## **TANK SPORTS, INC. AND SUBSIDIARY**

### **NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

place. For the customers on CNF (cost and freight), the Company recognizes sales and determines title has passed when goods arrive in the port of destination.

#### **Stock-based compensation**

Effective March 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123-R, "Share-Based Payment" ("SFAS 123-R"), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including stock options based on their fair values. SFAS 123-R supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), which the Company previously followed in accounting for stock-based awards. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) to provide guidance on SFAS 123-R. The Company has applied SAB 107 in its adoption of SFAS 123-R.

The Company does not have any stock options plan in effect and hence there are no stock options outstanding as of August 31, 2008 and 2007.

#### **Income taxes**

The Company utilizes SFAS No. 109 ("SFAS 109"), "Accounting for Income Taxes," which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

The Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), effective January 1, 2007. FIN 48 was issued to clarify the requirements of SFAS 109 relating to the recognition of income tax benefits. FIN 48 provides a two-step approach to recognizing and measuring tax benefits when the benefits' realization is uncertain. The first step is to determine whether the benefit is to be recognized; the second step is to determine the amount to be recognized:

- Income tax benefits should be recognized when, based on the technical merits of a tax position, the entity believes that if a dispute arose with the taxing authority and were taken to a court of last resort, it is more likely than not (i.e. a probability of greater than 50 percent) that the tax position would be sustained as filed; and
- If a position is determined to be more likely than not of being sustained, the reporting enterprise should recognize the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the taxing authority.

As a result of the implementation of FIN 48, the Company made a comprehensive review of its portfolio of tax positions in accordance with recognition standards established by FIN 48. The Company recognized no material adjustments to liabilities or stockholders' equity in lieu of the implementation. The adoption of FIN 48 did not have a material impact on the Company's financial statements.

#### **Foreign currency translation and comprehensive income**

The Company accounts for foreign currency translation pursuant to SFAS No. 52, "Foreign Currency Translation" ("SFAS 52"). The functional currency of the Company's subsidiary, PMI in China is the Chinese Yuan Renminbi (CNY). PMI's financial statements were maintained and presented in CNY, which were translated into U.S. Dollars (USD) in accordance with SFAS 52. Under SFAS 52, all assets

## **TANK SPORTS, INC. AND SUBSIDIARY**

### **NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

and liabilities are translated at the current exchange rate at the end of each fiscal period, stockholders' equity are translated at the historical rates, and income statement items are translated at the average exchange rates prevailing throughout the respective periods. Gains or losses on financial statement translation from foreign currency are recorded as separate components in the equity section of the balance sheet, under other comprehensive income in accordance with SFAS No. 130, "Reporting Comprehensive Income".

#### **Statement of cash flows**

In accordance with Statement of Financial Accounting Standards No. 95, "Statement of Cash Flows," cash flows from the Company's operations are calculated based upon the local currencies. As a result, amounts related to assets and liabilities reported on the statement of cash flows will not necessarily agree with changes in the corresponding balances on the balance sheet.

#### **Recent Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157 ("SFAS 157"), "Fair Value Measurements", which is effective for fiscal years beginning after November 15, 2007 with earlier adoption encouraged. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. In February 2008, the FASB issued FASB Staff Position FAS 157-2, Effective Date of FASB Statement No. 157 which delayed the effective date of SFAS 157 for all non-financial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis, until January 1, 2009. The Company has not yet determined the impact the implementation of SFAS 157 will have on the Company's non-financial assets and liabilities which are not recognized or disclosed on a recurring basis. However, the Company does not anticipate that the full adoption of SFAS 157 will significantly impact their consolidated financial statements.

In February 2007, FASB issued SFAS No. 159 ("SFAS 159"), "The Fair Value Option for Financial Assets and Financial Liabilities". This Statement permits entities to choose, at specified election dates, to measure eligible financial assets and liabilities at fair value that are not otherwise required to be measured at fair value. The objective of SFAS 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The Company adopted SFAS 159 on January 1, 2008, but the implementation of SFAS 159 did not have a significant impact on the Company's financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), "Business Combinations" ("SFAS 141R). SFAS 141R changes how a reporting enterprise accounts for the acquisition of a business. SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is effective for fiscal years beginning on or after December 15, 2008 and early adoption and retrospective application is prohibited. The impact of adopting SFAS 141R will depend on the nature and terms of future acquisitions.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements", which is an amendment of Accounting Research Bulletin ("ARB") No. 51. This statement clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. This statement changes the way the consolidated income statement is presented, thus requiring consolidated net income to be reported at amounts that include the amounts attributable to both parent and the noncontrolling interest. This statement is effective for the fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The adoption of SFAS 160 has changed the financial statement presentation regarding

## **TANK SPORTS, INC. AND SUBSIDIARY**

### **NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

non-controlling interests, but does not have significant impact on the Company's consolidated financial position, results of operations or cash flows.

In May 2008, FASB issued SFAS No. 162 ("SFAS 162"), "The Hierarchy of Generally Accepted Accounting Principles". This Standard identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles. SFAS 162 directs the hierarchy to the entity, rather than the independent auditors, as the entity is responsible for selecting accounting principles for financial statements that are presented in conformity with generally accepted accounting principles. The Standard is effective 60 days following SEC approval of the Public Company Accounting Oversight Board amendments to remove the hierarchy of generally accepted accounting principles from the auditing standards. The Company does not believe this pronouncement will impact its financial statements.

In April 2008, the FASB issued FASB Staff Position (FSP) FAS 142-3, "Determination of the Useful Life of Intangible Assets", which 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 FASB Statement No. 142, "Goodwill and Other Intangible Assets". This Staff Position is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. Application of this FSP is not expected to have a significant impact on the financial statements.

In May 2008, the FASB issued FASB Staff Position (FSP) APB 14-1, "Accounting for Convertible Debt That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)" ("FSP 14-1"). FSP 14-1 will be effective for financial statements issued for fiscal years beginning after December 15, 2008. The FSP includes guidance that convertible debt instruments that may be settled in cash upon conversion should be separated between the liability and equity components, with each component being accounted for in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest costs are recognized in subsequent periods. FSP 14-1 is not currently applicable to the Company since the Company does not have convertible debt.

In June 2008, the FASB issued FSP EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities". This FSP provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. The Company does not currently have any share-based awards that would qualify as participating securities. Therefore, application of this FSP is not expected to have an effect on the Company's financial reporting.

### **3. BASIC AND DILUTED NET LOSS PER SHARE**

Net loss per share is calculated in accordance with the Statement of financial accounting standards No. 128 (SFAS No. 128), "Earnings per share". SFAS No. 128 superseded Accounting Principles Board Opinion No.15 (APB 15). Net loss per share for all periods presented has been restated to reflect the adoption of SFAS No. 128. Basic net loss per share is based upon the weighted average number of common shares outstanding. Diluted net loss per share is based on the assumption that all dilutive convertible shares and stock options were converted or exercised. Dilution is computed by applying the treasury stock method. Under this method, options and warrants are assumed to be exercised at the beginning of the period (or at the time of issuance, if later), and as if funds obtained thereby were used to purchase common stock at the average market price during the period. Basic and diluted net losses per share were \$0.07 and \$0.16 for the years ended February 28, 2009 and February 29, 2008, respectively.

### **4. GOING CONCERN**

**TANK SPORTS, INC. AND SUBSIDIARY**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles which contemplate continuation of the Group as a going concern. However, the Group has accumulated deficit of \$9,464,690 as of February 28, 2009, including a net loss of \$2,675,980 for the year ended February 28, 2009 and \$5,744,719 for the year ended February 29, 2008. The continuing losses have adversely affected the liquidity of the Group. Losses might continue for the immediate future.

In view of the matters described in the preceding paragraph, recoverability of a major portion of the recorded asset amounts shown in the accompanying balance sheet is dependent upon continued operations of the Group, which in turn is dependent upon the Group's ability to raise additional capital, to increase more sales and to succeed in its future operations. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

Management has taken many steps to revise its operating and financial requirements, which it believes are sufficient to provide the Company with the ability to continue as a going concern. The acquisition and consolidation measures have strengthened its market position, included, but not limited to, restructuring of management and labor forces, consolidation of regional marketing facility, ERP system integration, better inventory control, further development of marketing promotion and sales network, reconsolidation of one centralized super distribution warehouse, and improvement of customer service infrastructure. The management has taken steps to upgrade the company's product line with more advanced engine technologies by collaborating with National Motor in Taiwan and Jianshe Motor Industry in China. . With all steps taken, the Management believes that it will significantly increase its overall productivity and revenues, reduce unnecessary costs and expenses, and achieve a goal of high profit margin with the controlled budget. Management has devoted considerable effort towards to (i) build "Tank", "Redcat" and Dazon brand names (ii) set up more dealers to increase sales (iii) liquidate less profitable products, and focus on selling more profitable products (iv) strive to reduce product costs and operating expenses through fully functioning of manufacturing capacity in Shanghai; (v) increase product range by utilization of R&D capacity ; and (vi) obtain additional equity. Management believes that the above actions will allow the Group to continue operations through the next fiscal year.

**5. ACCOUNTS AND BILLS RECEIVABLE**

Accounts and Bills Receivable was \$513,967 and \$134,863, net of allowance for doubtful debts of \$129,679 and \$223,838 as of February 28, 2009 and February 29, 2008, respectively.

**6. PREPAID EXPENSES AND OTHER CURRENT ASSETS**

Prepaid expenses and other assets consist of the following as of February 28, 2009 and February 29, 2008:

	February 28, 2009	February 29, 2008
Other receivables	\$ 76,733	\$ -
Prepaid insurance	8,945	\$ 14,841
Prepaid expenses	2,056	17,247
Prepaid Value Added Tax	-	36,096
Other current assets	4,397	-
	\$ 92,131	\$ 68,184

**7. PURCHASE ADVANCES**

As of May 31, 2008 and February 29, 2008, the Company had advances to suppliers of \$722,196 and \$276,380, respectively.

**8. INVENTORIES**

**TANK SPORTS, INC. AND SUBSIDIARY**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

Inventory consists of the following as of February 28, 2009 and February 29, 2008:

	<u>February 28, 2009</u>	<u>February 29, 2008</u>
Raw Materials - Parts	\$ 1,291,732	\$ 1,534,869
Work in progress	12,997	85,618
Finished goods :		
Vehicles	1,641,908	2,726,164
Accessories	<u>57,817</u>	<u>21,186</u>
Total Finished Goods	1,699,725	2,747,350
Less : Reserve for inventory obsolesce and slow-moving	<u>(131,515)</u>	<u>(367,946)</u>
Total Inventory	<u>\$ 2,872,939</u>	<u>\$ 3,999,891</u>

**9. PROPERTY, PLANT & EQUIPMENT**

Property, Plant & Equipment consist of the following as of February 28, 2009 and February 29, 2008:

	<u>May 31, 2008</u>	<u>February 29, 2008</u>
Building	\$ 899,100	\$ 1,282,473
Machinery & Equipment	661,231	289,103
Furniture & Fixtures	86,760	86,760
Electronic Equipment	482,336	547,178
Automobile	139,242	108,853
Construction in progress	-	7,253
Less : Accumulated depreciation	<u>(727,321)</u>	<u>(392,423)</u>
Total	<u>\$ 1,541,348</u>	<u>\$ 1,929,197</u>

Depreciation expenses were \$267,324 and \$197,810 for the years ended February 28, 2009 and February 29, 2008, respectively.

**10. INVESTMENT IN EQUITY**

Shanghai Dazon has 50% ownership of Shanghai Dazon Northern. The Company uses equity method to account for the operating results of this investment. The Company's share of this investment amounts to \$34,995 and \$55,096 as of February 28, 2009 and February 29, 2008, respectively. The Company's share of operating loss on this investment amounts to \$26,115 and \$5,436 for the years ended February 28, 2009 and February 29, 2008, respectively.

**11. INTANGIBLE ASSETS**

Intangible assets consist of the following:

	<u>May 31, 2008</u>	<u>February 29, 2008</u>
Amortized intangibles:		
Shanghai Dazon trademark, net of accumulated amortization of \$471 and \$112	\$ 1,556	\$ 1,837
Licenses, net of accumulated amortization of \$411		

**TANK SPORTS, INC. AND SUBSIDIARY**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

and \$108	1,578	1,805
Land use rights, net of accumulated amortization of and \$143,014 and \$30,311	3,943,782	3,870,978
 Total amortized intangibles	 3,946,916	 3,874,620
 Unamortized intangibles:		
"Redcat" trademark	1,175	975
Permits	1,159,175	1,182,285
Total unamortized intangibles	1,160,350	1,183,260
 Goodwill	 1,178,492	 1,178,492
 Total intangible assets	 \$ 6,285,758	 \$ 6,236,372

**1) Trade Marks**

The trade marks of the Company amount to \$2,731 and \$2,812 as of February 28, 2009 and February 29, 2008, respectively, and consist of the trade mark of "Redcat" of \$1,175 and \$975 and the fees incurred by Shanghai Dazon in applying for brand name product export rights of \$1,556 and \$1,837 as of February 28, 2009 and February 29, 2008, respectively. The "Redcat" trademark is deemed to have an indefinite useful life. The Shanghai Dazon trademark has a useful life of 10 years from the date of initial acquisition.

**2) Licenses and Permits**

The Company owns licenses to distribute vehicles in various states in the US and other countries. The Company also directly owns certificates that permit the Company to import vehicles legally into the US.

The Company's subsidiary Shanghai Dazon own licenses and permits to sell products in Europe and United States. The licenses and permits enable the Group to manufacture a variety of products that have ready markets.

The Company's licenses have a useful life of 10 years from the date of initial acquisition, whereas permits are deemed to have indefinite useful life.

**3) Land Use Right**

The Company's subsidiary Shanghai Dazon owns two pieces of land in Shanghai and with land use right for a period of 50 years from the date of grant for industrial use.

**4) Goodwill**

Goodwill in the amount of \$1,178,492 was resulted from the PMI acquisition on November 15, 2007. No changes in the carrying amount of the goodwill have occurred for the three months and the six months ended August 31, 2008.

Goodwill in the amount of \$1,615,716 was resulted from the Redcat acquisition on January 30, 2007. The company performed an impairment testing on this goodwill and concluded that there was an impairment of \$1,615,716 as to the carrying value of goodwill as of February 29, 2008. No changes have occurred for the year ended February 28, 2009.

**12. LOANS PAYABLE**

**TANK SPORTS, INC. AND SUBSIDIARY**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

On June 1, 2005, the company signed a five year note payable against auto loan. The loan was unsecured, with an interest of 5.90% with monthly payment of \$743. As of February 28, 2009 and February 29, 2008, this note payable was \$11,446 and \$19,418, of which \$3,886 and \$7,560 were current payable, and \$7,560 and \$11,858 were non-current payable, respectively.

On March 20, 2006, the company obtained a loan payable of \$372,259 from a non-related party. The note is secured by various computer equipments and software purchased from Microsoft Capital, with an annual interest rate of 5.00%, and due on June 1, 2011. As of February 28, 2009 and February 29, 2008, the balance of the note payable was \$213,827 and \$262,009, of which \$62,715 and \$70,800 were current payable and \$151,112 and \$191,209 were non-current payable, respectively.

On July 14, 2006, the company obtained a line of credit of \$6,500,000 from United Commercial Bank. The outstanding payable ended the earlier of July 31, 2007 or when the Company paid the note in full, including principal, interest, and all the expenses involved. The annual interest rate on the loan was 8.5%. The line of credit was secured by the Company's business assets, real property, certificates of deposit of \$2,500,000 and guaranteed by the major shareholders and by the Company's affiliate. This line of credit was fully paid off in October 2007 with a new line of credit obtained from First General Bank. Accordingly, the company terminated the line of credit with United Commercial Bank.

On September 12, 2007, the Company obtained \$7,280,000 credit line from First General Bank. The annual interest rate was 0.5% over the Collateralized Deposit Rate on the \$3,280,000 credit line and prime rate on the \$4,000,000 credit line. These credit lines were to replace the existing credit line granted by United Commercial Bank. The loan was secured by the Company's business assets, real property, and guaranteed by the major shareholders and by the Company's affiliate. The outstanding balance under this line of credit amounted to \$3,311,209 and \$4,309,665 as of February 28, 2009 and February 29, 2008, respectively. The interest expense on this bank line of credit for the years ended February 28, 2009 and February 29, 2008 was \$196,885 and \$283,066, respectively.

The company had bank acceptance of \$0 and \$1,591,386 from First General Bank as of February 28, 2008 and February 29, 2008, respectively, which composed of various lines of credit. The bank acceptance was unsecured, due in 120 or 150 days, and interest free. The bank acceptance was classified as Loans payable in the accompanying consolidated financial statements.

On December 29, 2007, Shanghai Dazon obtained a loan of CNY 14,000,000 from a Chinese Bank with an interest rate of 8.217% per annum. The loan balance was \$2,046,933 and \$1,970,222 as of August 31, 2008 and February 29, 2008, respectively. This loan was secured by the two pieces of land and the building of Shanghai Dazon and had a maturity date on December 28, 2008, which had been extended thereafter.

On May 25, 2008, Shanghai Dazon obtained a loan of CNY 2,700,000 from a Chinese bank for a period of 5 months with maturity date on October 15, 2008, which was secured by a letter of credit from Tank Guangzhou, and had an interest of 6.8985%. The loan balance was \$312,191 as of February 28, 2009.

**13. NOTES PAYABLE**

On February 29, 2008, the Company borrowed \$1,500,000 from a non-related party with an interest rate of 4.41%. This unsecured note payable was due on February 28, 2009, and had been negotiated for extension. The note payable was subordinated to the line of credit of \$7,280,000.

On February 15, 2007, the Company signed the "Second Amended and Restated Promissory Note and Security Agreement" with Hexagon Financial, LLC ("Payee"). The Company is indebted to the Payee of \$882,839 which reflected the book value of Payee's inventory in related to the acquisition of Redcat as of January 28, 2007. The note has a fixed interest rate of 5% per annum. Pursuant to the agreement, the Company shall make \$100,000 payments on April 5, 2007 and April 10, 2007, and \$300,000 immediately upon the closing of the line of credit with United Commercial Bank but no later than August 1, 2007. And then the Company should make payments of \$50,000 for every month starts in June 1, 2007 and ends on

**TANK SPORTS, INC. AND SUBSIDIARY**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

January 31, 2008. Any default amount under this agreement bears interest at a rate equal to ten percent (10%) per annum. In November 2007, the Payee promised to reduce the outstanding note payable to \$275,000 and to amend the payment schedule if the Company adheres to the new payment schedule and the stock repurchase agreement, as defined in Note 16. As of February 29, 2008, the Company had a payable of \$500,740 due the Payee. In May 2008, the Company and the Payee negotiated the terms of the settlement of the stock repurchase agreement and the note settlement. As a result of such negotiations, the Company paid the Payee \$250,000 on May 10, 2008 and \$180,000 on May 30, 2008 to complete the settlement. The Company bought back 130,151 shares at \$1.05 a share and recorded another treasury shares acquisition for \$136,659 as final settlement of the Payee's debt. The resulting gain from this settlement was \$89,855 and was included in Other Income of the consolidated income statement for the year ended February 28, 2009.

**14. RELATED PARTIES**

1. Related party receivable

As of February 28, 2009 and February 29, 2008, receivable from related parties amounted to \$2,263,396 and \$2,910,379, respectively. These included the following:

On August 1, 2006, the Company signed a credit agreement with LONG Sa De CV ("Long Company"), whereas the Company agrees that Long Company utilizes the line of credit of the Company up to \$5,500,000 for the Letter of Credit issued to vendors in China each year. In exchange, Long Company agrees to pay up to 6% of service charges to the Company to cover the lending costs and service charges from its bank. The Company's Chairman and Director are also the officers of Long Company. As of February 28, 2009 and February 29, 2008, total \$2,257,400 and \$1,667,573 was due from Long Company, respectively, which was recorded as related party receivable in the accompanying financial statements.

The Company also had a purchase advance to Long Company in the amount of \$617,319 and \$972,226 as of February 28, 2009 and February 29, 2008, respectively.

The Group had net receivable from Shanghai Dazon Northern of \$0 and \$177,631 as of February 28, 2009 and February 29, 2008. Shanghai Dazon owns 50% of Shanghai Dazon Northern and uses equity method to account for the operating results.

Other related party receivable also included \$0 and \$1,000 receivable from officer, and \$5,995 and \$0 receivable from former officers of Tank (Arizona) as of February 28, 2009 and February 29, 2008, respectively.

The Company had a receivable from "Steady Star Inc." in the amount of \$0 and \$85,954 as of February 28, 2009 and February 29, 2008, respectively. The Company's Chairman and Director are also the major shareholders and officers of Steady Star Inc. The receivables were unsecured, due on demand and interest free.

2. Due to related parties

On November 15, 2007, PMI bought back the minority shares of Shanghai Dazon and PMI Hong Kong from Jaguar Investments Ltd. Prior to the shares buyback, PMI owned 80.73% of Shanghai Dazon and 75% of PMI Hong Kong. PMI purchased 1,794,450 PMI common shares from Smartman Enterprise Ltd. for \$170,900 and use these shares purchased to exchange the 17.09% ownership of Shanghai Dazon from Jaguar Investments Ltd. PMI purchased 151,540 PMI common shares from Smartman Enterprise Ltd. for \$29,100, and use these shares purchased to exchange 25% ownership in PMI Hong Kong from Jaguar Investments Ltd. After the shares exchange, PMI owns 97.82% of Shanghai Dazon and 100% of PMI Hong Kong. The shareholders of Smartman Enterprises Ltd. are also the former officers of PMI. As of February 28, 2009 and February 29, 2008, the amount due to Smartman Enterprise Ltd. was \$169,670 and \$382,216, respectively.

**TANK SPORTS, INC. AND SUBSIDIARY**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

3. Loans from Related Parties

1) Loans from officers:

As of February 28, 2009 and February 29, 2008, the Company had loans of \$60,000 and \$125,183 due to former officers, respectively. These loans carried interests at 6.5% per annum and are payable due on demand.

On February 10, 2008, the Company obtained a loan of \$1,750,000 from its director and officer. This loan carries an interest at 7% per annum and is payable on February 10, 2009, which has been extended. In the event that the Company cannot repay the loan on maturity date, the director and officer has the right to demand for repayment of principal and interest in full or ask the Company to issue 5,128,644 shares of its common stock as settlement of the loan. As of February 28, 2009 and February 29, 2008, the accrued interest on the loan was \$128,877 and \$6,377, respectively.

On May 4, 2008, the Company obtained a loan of \$130,000 from its director. This loan carried an interest at 6% per annum and was payable on May 4, 2009, which has been extended. This loan was unsecured and as of February 28, 2009, the accrued interest on the loan was \$6,347.

On August 1, 2008, the Company obtained an unsecured line of credit of \$200,000 from its director and officer. This loan carried an interest at 6% per annum with a maturity date on July 31, 2009. As of February 28, 2009, in addition to the unpaid balance on this line of credit, the Company also owed \$254,111 to the same director and officer.

2) Loans from related party

The Group obtained loans from Guangzhou Tank (USA) Vehicles Co., Ltd. (Tank Guangzhou) for working capital purposes. These loans were unsecured, interest free and due on demand. As of February 28, 2009 and February 29, 2008, the amount due was \$102,000 and \$1,351,012, respectively. The Company's Chairman and Director are also the officers of Tank Guangzhou.

As of February 28, 2009 and February 29, 2008, the Company had trade payables of \$1,093,150 and \$770,385 due to Tank Guangzhou, respectively.

**15. SHARES TO BE ISSUED**

The Company classifies all shares to be issued as liabilities. Once the Company issues shares, the amounts are classified as Common Stock.

As of February 29, 2008, the Company had total shares to be issued of 1,600,000 amounted to \$1,520,000, pursuant to the definitive Stock Purchase Agreement dated November 15, 2007. The 1,600,000 shares were issued on May 20, 2008 at \$0.95 per share.

**16. STOCKHOLDERS' EQUITY**

On December 4, 2006, the Company entered into an Investment Agreement with an investor, Dutchess Private Equities Fund, L.P. ("the Investor"). Pursuant to this Agreement, the Investor shall commit to purchase up to \$10,000,000 of the Company's common stock over the course of thirty-six (36) months. The amount that the Company shall be entitled to request from each purchase shall be equal to, at the Company's election, either (i) \$150,000 or (ii) 200% of the average daily volume (U.S. market only) of the common stock for the three (3) trading days prior to the applicable put notice date, multiplied by the average of the three (3) daily closing prices immediately preceding the put date. The put date shall be the date that the Investor receives a put notice of a draw down by the Company. The purchase price shall be set at ninety-five percent (95%) of the lowest closing Best Bid price of the common stock during the pricing period. The pricing period shall be the five (5) consecutive trading days immediately after the put notice

**TANK SPORTS, INC. AND SUBSIDIARY**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

date. There are put restrictions applied on days between the put date and the closing date with respect to that particular Put. During this time, the Company shall not be entitled to deliver another put notice. Further, the Company shall reserve the right to withdraw that portion of the Put that is below seventy-five percent (75%) of the lowest closing bid prices for the 10-trading day period immediately preceding each put notice. Pursuant to the Investment Agreement, 27,000 shares were issued to the investor at market price of \$.52 a share for a total of \$14,033 on April 9, 2007. The Company did not issue any shares under the Investment Agreement during the year ended February 28 2009.

On December 22, 2006, the Company signed Web Site Development Agreement with a consultant and agreed to pay \$17,500 worth of S-8 stock after the completion of the website. 21,875 shares were issued on April 12, 2007.

On December 28, 2006, the Company board of directors approved the Private Placement Memorandum and started to offer up to 500 units of the Company's securities at \$10,000 per unit. Each unit consists of 10,500 shares of the Company's common stock ("Shares") and 5,000 warrants ("Warrants") to purchase one share of the Company's common stock at an exercise price of \$2.00 per share. The Warrants will be immediately exercisable and will remain exercisable for one year. The Unit offered including the Shares, Warrants and the common shares issuable exercise of the Warrants, are being issued as restricted securities under the federal securities laws, and investors' right to sell, transfer, pledge or otherwise dispose of any of the shares will be limited by the 1933 Act and the rules and regulations and any applicable state securities laws. No sales commissions will be paid to the Company in connection with this offering. The offering was terminated on February 28, 2007 and the Company sold 1,144,500 shares of common stock and granted 545,000 shares of Warrants in this offering. The cash proceeds for the issuance of shares amounted to \$1,090,000. The Company actually issued the 1,144,500 shares on March 9, 2007. The fair value of the warrants was \$27,567 and was calculated using the Black-Scholes option pricing model using the following assumptions: risk free rate of return of 4.75%, volatility of 103%, and dividend yield of 0% and expected life of one year. The Company recorded the value of warrants net of the gross proceeds received out of this offering.

On January 30, 2007, the Company completed the acquisition of one hundred percent (100%) of the issued and outstanding common stock of Lowprice.com, Inc., an Arizona corporation d/b/a RedCat Motors (the "Redcat") pursuant to a Stock Purchase Agreement, as amended (the "Agreement") by and among the Company, (the Shareholders), the Company and Hexagon. The Company purchased 100% of the common stock of Redcat from the Shareholders for an aggregate purchase price of \$1. Further, the Company made a capital contribution to Redcat of \$1,000,000 in cash, which was paid to the Redcat upon Closing. The Company further issued to Hexagon 400,000 shares of the common stock of the Company which was valued at the fair market price and an additional \$200,000 capital contribution in cash for the settlement of debt.

On February 1, 2007, the Company board of directors approved to issue \$50,943 worth of unrestricted shares to former Redcat employees as bonus for 90 days of employment starting February 1, 2007. The 81,914 shares were actually issued at the market prices to the eligible employees on April 11, 2007.

On May 20, 2007, the Company board of directors issued 2,080,000 shares of common stocks and 250,000 warrants excisable for two years to an investor pursuant of the Private Placement Memorandum. The proceeds received from the issuance of the shares consists of the cash of \$900,000 and \$100,000 direct purchase deposit to a vendor. The fair value of the warrants \$52,641 upon issuance was calculated by using the Black-Scholes option pricing model and followed the assumptions of: risk free rate of return of 4.92%, volatility of 93%, dividend yield of 0% and expected life of two years. The Company recorded the value of warrants net of the gross proceeds received out of this offering. This investor has become an independent board member.

On August 16, 2007, the Company signed Share Buyback Agreement with Hexagon Financial LLC. To purchase 264,350 common shares among the 400,000 shares that the Company issued to Hexagon in February 2007. Pursuant to the First Amendment to Stock Purchase Agreement Tank agreed to issue to

**TANK SPORTS, INC. AND SUBSIDIARY**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

Hexagon 400,000 shares and also agreed to offer Hexagon price protection of \$1.00 per share for the 400,000 shares issued if the shares were sold in the public market within 180 days following the close of purchase transaction. Hexagon has sold a total of 135,650 shares for \$69,699 and had \$65,951 shortfall. Hexagon agrees to sell the rest of 264,350 shares to Tank at a price of \$1.05 per share for total of \$277,567.5 Tank paid \$65,951 in 3<sup>rd</sup> Quarter for the shortfall amount and bought 108,618 shares as treasury shares from Hexagon at cost of \$114,049. In May, 2008, the Company and Hexagon reached agreement on the settlement of note payable and repurchase of shares, and accordingly the Company paid a total of \$430,000 to Hexagon in May 2008 to settle the repurchase of stock and note payable (See Note 13).

On November 15, 2007, the Company completed the acquisition of one hundred percent (100%) of the issued and outstanding common stock, total of the 10,500,000 shares of People's Motor International Co, Ltd and its direct and indirect owned subsidiaries ("PMI") pursuant to a Stock Purchase Agreement (the "Agreement") by the Company and the shareholders of PMI. Pursuant to the Agreement, the Company shall issue aggregate common shares of 4,000,000, which are restricted and control securities pursuant to Rule 144 in the Securities Exchange Act of 1934. The Company issued 2,400,000 shares of restricted common stock amounting to \$2,280,000 and 1,500,000 warrants exercisable within 30 months from closing date on November 20, 2007. The Black Schole value of the warrants was \$883,661 upon issuance. The remaining 1,600,000 shares of common stock were issued on May 20, 2008 (See Note 15).

**17. WARRANTS**

The total outstanding warrants as of February 28, 2009 and February 29, 2008 were 1,750,000. There was no warrant activity for the three-month period ended August 31, 2008.

The following is a summary of the status of warrants outstanding at February 28, 2009 and February 29, 2008:

Outstanding Warrants			Exercisable Warrants			
-----			-----			
Exercise		Average				
Price	Number	Remaining	Average Exercise	Price	Number	Intrinsic Value
		Contractual Life				
\$1.50	250,000	1.24		\$1.50	250,000	-
\$0.64	1,500,000	2.21		\$0.64	1,500,000	\$240,000

The assumptions used in calculating the fair value of options granted using the Black-Scholes option pricing model were as follows:

The 250,000 warrants granted on May 20, 2007:

Risk-free interest rate	4.92%
Expected life of the options	2.00 year
Expected volatility	93%
Expected dividend yield	0

The 1,500,000 warrants granted on November 15, 2007:

Risk-free interest rate	3.01%
Expected life of the options	2.50 year
Expected volatility	87%
Expected dividend yield	0

**TANK SPORTS, INC. AND SUBSIDIARY**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**18. COMMITMENTS AND CONTINGENCIES**

The Company is subject to a lawsuit, product liability, leases and other matters. In determining required reserves related to these items, the Company carefully analyzes case and considers the likelihood of adverse judgments or outcomes, as well as the potential range of possible loss. The required reserves are monitored on an ongoing basis and are updated based on new developments or new information in each matter.

**Lawsuit:**

On August 18, 2007, Luoyang North Industry Company (Luoyang North) sued Shanghai Dazon to People's Court of Luoyang Jianxi District (District Court), complaining that Shanghai Dazon defaulted in the payment of \$372,376 fee according to the cooperation agreement and supplementary cooperation agreement that the two parties signed in June 13, 2002 and July 30, 2002. On October 16, 2007, the District Court ruled on the judgment that Shanghai Dazon should pay Luoyang North \$372,376 within 10 days, together with the accrued interest at popular bank interest rate by August 30, 2007. On November 19, 2007, Shanghai Dazon filed appeal to Luoyang City Intermediate People's Court (City Court) that Shanghai Dazon should pay the 2005 and 2006 contract fee total \$236,967 by installments, while the contract payment of 2007 of 4135,409 is not due until the end of 2007. In April 2008, Shanghai Dazon took another approach and appeal the claim of Luoyang North to the City Court on the ground that the basis of the contract fee is invalid. The City Court re-examined the case to review the merits of Shanghai Dazon's appeal and informed Luoyang North and Shanghai Dazon on May 26, 2008 that the case will be set for re-trial by the District Court. As of the date of this report the time for re-trial has not been set. As of February 29, 2008, Shanghai Dazon has provided \$410,463 in its accounts covering the amount of litigation and accrued fees for the two months prior to February 29, 2008.

**Product Liability Matters:**

Additionally, the Company is involved in product liability suits related to the operation of its business. The Company accrues for claim exposures that are probable of occurrence and can be reasonably estimated. The Company also maintains insurance coverage for product liability exposures. The Company believes that its accruals and insurance coverage are adequate and that product liability will not have a material adverse effect on the Company's consolidated financial statements.

**Leases:**

On August 1, 2005, Tank entered into a lease agreement for the new facilities in which they operate. The lessors are Tank's two main shareholders who are also Tank's directors and officers. The term of the lease is 60 months with monthly payments of \$19,900. Rent expense for this lease was \$238,800 for the year ended February 28, 2009.

Minimum annual rent expense for Tank for the next 2 years subsequent to February 28, 2009 is as follows:

Period	Amount
1 year after	\$238,800
2 year after	\$ 99,500

On December 25, 2005, the Company's subsidiary Redcat entered into a lease agreement for a term of 36 months until January 31, 2009. However, the Company had stopped paying rent for Redcat's lease since September, 2008. The rent expense for this lease for the years ended February 28, 2009 and February 29, 2008 was \$128,819 and \$254,515, respectively.

On May 1, 2005, the Company's subsidiary Dazon Arizona Inc, entered into a lease agreement for a term of 60 months until April 30, 2010. The monthly payment for this rent was \$9,453 for the periods from June

**TANK SPORTS, INC. AND SUBSIDIARY**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

1, 2007 to April 31, 2008. The rent expense for the periods from June 1, 2008 to August 31, 2008 was \$28,357. The lease was guaranteed by a former officer of PMI and in return PMI provides a letter of indemnity. After the acquisition of PMI, the Company took over the guarantee. Starting June 2008, the rental space of Dazon Arizona was subleased to a third party. It has defaulted on rental payments since August, 2008, and the Company had stopped paying rent for Dazon Arizona's lease since September, 2008. The rent expense for this lease for the years ended February 28, 2009 and February 29, 2008 was \$28,359 and 40,433, respectively.

On February 29, 2008, PMI entered into a short lease ending February 28, 2009 for its Hong Kong office. The monthly rental is \$962 and the rent expense under this lease was \$11,538 and \$5,772 for the years ended February 28, 2009 and February 29, 2008, respectively.

**19. NONCONTROLLING INTEREST**

The noncontrolling shareholder of Shanghai Dazon has 2.18% ownership of Shanghai Dazon. The noncontrolling interest in Shanghai Dazon amounted to \$72,009 and \$96,331 as of February 28, 2009 and February 29, 2008, respectively.