TEAM INC
Form 10-Q
April 08, 2011
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended February 28, 2011

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period to

Commission file number 001-08604

TEAM, INC.

(Exact name of registrant as specified in its charter)

Texas	**74-1765729**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification Number)**
200 Hermann Drive, Alvin, Texas	**77511**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code (281) 331-6154

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨ Smaller reporting company ¨

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

On April 5, 2011 there were 19,557,238 shares of the Registrant s common stock including 89.569 shares of treasury stock outstanding.

Table of Contents

INDEX

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

TEAM, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED BALANCE SHEETS

(in thousands, except share and per share data)

	February 28, 2011 (unaudited)	May 31, 2010
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 22,635	$ 12,610
Receivables, net of allowance of $3,903 and $4,934	99,555	109,368
Inventory	20,862	19,733
Income tax receivable	3,364	
Deferred income taxes	2,260	2,646
Prepaid expenses and other current assets	5,254	5,988
Total Current Assets	153,930	150,345
Property, plant and equipment, net	56,356	55,229
Intangible assets, net of accumulated amortization of $2,271 and $2,010	1,293	1,498
Goodwill (see Note 1)	103,097	55,739
Other assets, net	1,946	2,081
Deferred income taxes	340	97
Total Assets	$ 316,962	$ 264,989
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Current portion of long-term debt	$ 291	$ 313
Accounts payable	14,259	19,010
Other accrued liabilities	27,743	21,781
Income tax payable		1,877
Deferred income taxes	19	21
Total Current Liabilities	42,312	43,002
Deferred income taxes	12,154	8,947
Long-term debt	68,979	47,848
Total Liabilities	123,445	99,797
Commitments and Contingencies		
Stockholders Equity:		
Preferred stock, 500,000 shares authorized, none issued		
Common stock, par value $0.30 per share, 30,000,000 shares authorized; 19,550,738 and 18,988,250 shares issued	5,864	5,696
Non-controlling interest	4,926	
Additional paid-in capital	76,417	69,380
Retained earnings	108,326	92,553

Accumulated other comprehensive loss	(672)	(2,437)
Treasury stock at cost, 89,569 and 0 shares	(1,344)	
Total Stockholders Equity	193,517	165,192
Total Liabilities and Stockholders Equity	$ 316,962	$ 264,989

See notes to unaudited consolidated condensed financial statements.

3

Table of Contents

TEAM, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended February 28,		Nine Months Ended February 28,	
	2011	2010	2011	2010
Revenues	$ 108,820	$ 104,112	$ 346,462	$ 328,341
Operating expenses	78,083	75,593	240,435	230,940
Gross margin	30,737	28,519	106,027	97,401
Selling, general and administrative expenses	27,616	26,456	82,969	82,888
Earnings from unconsolidated affiliates	120	29	755	520
Operating income	3,241	2,092	23,813	15,033
Interest expense, net	525	667	1,371	2,197
Foreign currency (gain) loss	(42)	2,075	(53)	2,047
Earnings (loss) before income taxes	2,758	(650)	22,495	10,789
Provision for income taxes (see Note 3)	(1,173)	(223)	6,722	4,250
Net income (loss)	3,931	(427)	15,773	6,539
Less: Income attributable to non-controlling interest	34		9	
Net income (loss) available to Team shareholders	$ 3,897	$ (427)	$ 15,764	$ 6,539
Net income (loss) per share: Basic	$ 0.20	$ (0.02)	$ 0.82	$ 0.35
Net income (loss) per share: Diluted	$ 0.19	$ (0.02)	$ 0.79	$ 0.34

See notes to unaudited consolidated condensed financial statements.

Table of Contents

TEAM, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

	Three Months Ended February 28,		Nine Months Ended February 28,	
	2011	**2010**	**2011**	**2010**
Net income (loss)	$ 3,931	$ (427)	$ 15,773	$ 6,539
Foreign currency translation adjustment	4,061	(2,258)	6,393	1,089
Interest rate swap		193		626
Foreign currency hedge	(933)	1,640	(1,868)	572
Tax provision attributable to other comprehensive income (loss)	(3,551)	(666)	(2,760)	(1,184)
Other comprehensive income (loss)	3,508	(1,518)	17,538	7,642
Less: Other comprehensive income attributable to non-controlling interest	37		9	
Other comprehensive income (loss) available to Team shareholders	$ 3,471	$ (1,518)	$ 17,529	$ 7,642

See notes to unaudited consolidated condensed financial statements.

5

Table of Contents

TEAM, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine Months Ended February 28, 2011	Nine Months Ended February 28, 2010
Cash Flows From Operating Activities:		
Net income	$ 15,773	$ 6,539
Adjustments to reconcile net income to net cash provided by operating activities:		
Earnings from unconsolidated affiliates	(755)	(520)
Income attributable to non-controlling interest	(9)	
Depreciation and amortization	10,686	9,224
Loss on asset sales	129	
Amortization of deferred loan costs	228	233
Foreign currency (gain) loss	(53)	2,047
Deferred income taxes	578	1,170
Write down of fixed assets		85
Non-cash compensation cost	3,848	3,876
(Increase) decrease:		
Receivables	17,823	10,904
Inventory	(851)	(38)
Prepaid expenses and other current assets	1,309	3,242
Increase (decrease):		
Accounts payable	(6,479)	(2,700)
Other accrued liabilities	3,020	132
Income taxes	(5,483)	(80)
Net cash provided by operating activities	39,764	34,114
Cash Flows From Investing Activities:		
Capital expenditures	(8,064)	(5,513)
Business acquisitions, net of cash acquired	(41,376)	
Distributions from joint venture	750	600
Increase in other assets, net	(138)	(1,034)
Net cash used in investing activities	(48,828)	(5,947)
Cash Flows From Financing Activities:		
Borrowings (payments) under revolving credit agreement, net	19,435	(18,280)
Payments related to term loans	(243)	(4,733)
Tax effect from share based payment arrangements	(844)	546
Insurance note payments		(3,218)
Issuance of common stock from share based payment arrangements	1,566	401
Purchase of treasury stock	(1,344)	
Net cash provided by (used in) financing activities	18,570	(25,284)
Effect Of Exchange Rate Changes On Cash	519	(1,350)
Net Increase In Cash And Cash Equivalents	10,025	1,533
Cash And Cash Equivalents At Beginning Of Period	12,610	12,632

Cash And Cash Equivalents At End Of Period	$ 22,635	$ 14,165

See notes to unaudited consolidated condensed financial statements.

Table of Contents

TEAM, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED CONDENSED

FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PRACTICES

Introduction. Unless otherwise indicated, the terms Team, Inc., Team, the Company, we, our and us are used in this report to refer to Tea Inc., to one or more of our consolidated subsidiaries or to all of them taken as a whole. We are incorporated in the State of Texas and our company website can be found at *www.teamindustrialservices.com*. Our corporate headquarters is located at 200 Hermann Drive, Alvin, Texas, 77511 and our telephone number is (281) 331-6154. Our stock is traded on the NASDAQ Global Select Market (NASDAQ) under the symbol TISI and our fiscal year ends on May 31 of each calendar year.

We are a leading provider of specialty maintenance and construction services required in maintaining high temperature and high pressure piping systems and vessels that are utilized extensively in heavy industries. We offer an array of complementary services including:

- Inspection and Assessment,
- Field Heat Treating,
- Leak Repair,
- Fugitive Emissions Control,
- Hot Tapping,
- Field Machining,
- Technical Bolting, and
- Field Valve Repair.

We offer these services in over 100 locations throughout the world. Our industrial services are available 24 hours a day, 7 days a week, 365 days a year. We market our services to companies in a diverse array of heavy industries which include the petrochemical, refining, power, pipeline, steel, pulp and paper industries, as well as municipalities, shipbuilding, original equipment manufacturers (OEMs), distributors, and some of the world s largest engineering and construction firms. Our services are also provided across a broad geographic reach.

Basis for Presentation. These interim financial statements are unaudited, but in the opinion of our management, reflect all adjustments, consisting of normal recurring adjustments necessary for a fair presentation of results for such periods. The consolidated condensed balance sheet at May 31, 2010 is derived from the May 31, 2010 audited consolidated financial statements. The results of operations for any interim period are not necessarily indicative of results for the full year. These financial statements should be read in conjunction with the financial statements and notes thereto contained in our annual report on Form 10-K for the fiscal year ended May 31, 2010.

Consolidation. The consolidated financial statements include the accounts of Team, Inc. and our majority-owned subsidiaries where we have control over operating and financial policies. Investments in affiliates in which we have the ability to exert significant influence over operating and financial policies, but where we do not control the operating and financial policies, are accounted for using the equity method. All material intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates. Our accounting policies conform to Generally Accepted Accounting Principles in the U.S. (GAAP). Our most significant accounting policies are described below. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and judgments that affect our reported financial position and results of operations. We review significant estimates and judgments affecting our consolidated financial statements on a recurring basis and record the effect of any necessary adjustments prior to their publication. Estimates and judgments are based on information available at the time such estimates

Table of Contents

and judgments are made. Adjustments made with respect to the use of these estimates and judgments often relate to information not previously available. Uncertainties with respect to such estimates and judgments are inherent in the preparation of financial statements. Estimates and judgments are used in, among other things, (1) aspects of revenue recognition, (2) valuation of tangible and intangible assets and subsequent assessments for possible impairment, (3) the fair value of the non-controlling interest in subsidiaries that are not wholly-owned, (4) estimating various factors used to accrue liabilities for workers compensation, auto, medical and general liability, (5) establishing an allowance for uncollectible accounts receivable, (6) estimating the useful lives of our assets and (7) assessing future tax exposure and the realization of tax assets (see Note 3).

Income Taxes. We follow the guidance of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 740, *Income Taxes* (ASC 740) which requires that we use the asset and liability method of accounting for deferred income taxes and provide deferred income taxes for all significant temporary differences. As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax payable and related tax expense together with assessing temporary differences resulting from differing treatment of certain items, such as depreciation, for tax and accounting purposes. These differences can result in deferred tax assets and liabilities, which are included within our consolidated balance sheets. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that it is more likely than not (a likelihood of more than 50%) that some portion or all of the deferred tax assets will not be realized, we must establish a valuation allowance. We consider all available evidence to determine whether, based on the weight of the evidence, a valuation allowance is needed. Evidence used includes information about our current financial position and our results of operations for the current and preceding years, as well as all currently available information about future years, including our anticipated future performance, the reversal of deferred tax liabilities, share-based compensation and tax planning strategies.

Fair Value of Financial Instruments. Our financial instruments consist primarily of cash, cash equivalents, accounts receivable, accounts payable and debt obligations. The carrying amount of cash, cash equivalents, trade accounts receivable and trade accounts payable are representative of their respective fair values due to the short-term maturity of these instruments. The fair value of our banking facility is representative of the carrying value based upon the variable terms and management s opinion that the current rates available to us with the same maturity and security structure are equivalent to that of the banking facility.

Cash and Cash Equivalents. Cash and cash equivalents consist of all demand deposits and funds invested in highly liquid short-term investments with original maturities of three months or less.

Inventory. Inventory is stated at the lower of cost (first-in, first-out method) or market. Inventory includes material, labor and certain fixed overhead costs.

Property, Plant and Equipment. Property, plant and equipment are stated at cost less accumulated depreciation and amortization. Leasehold improvements are amortized over the shorter of their respective useful life or the lease term. Depreciation and amortization of assets are computed by the straight-line method over the following estimated useful lives of the assets:

Classification	**Useful Life**
Buildings	20-40 years
Leasehold improvements	2-10 years
Machinery and equipment	2-12 years
Furniture and fixtures	2-10 years
Computers and computer software	2-5 years
Automobiles	2-5 years

Table of Contents

Goodwill and Other Intangible Assets. Goodwill represents the excess of costs over fair value of assets of businesses acquired. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but are instead tested for impairment at least annually in accordance with the provisions of ASC 350, *Intangibles Goodwill and Other* (ASC 350). Intangible assets with estimated useful lives are amortized over their respective estimated useful lives to their estimated residual values and reviewed for impairment in accordance with ASC 350.

We operate in only one segment industrial services (see Note 11). Within the industrial services segment, we are organized as two divisions. Our TCM division provides the services of inspection and assessment and field heat treating. Our TMS division provides the services of leak repair, hot tapping, field machining, fugitive emissions control, technical bolting and field valve repair. Each division has goodwill relating to past acquisitions and we assess goodwill for impairment at the lower TCM and TMS divisional level.

Our annual goodwill impairment test is conducted as of May 31 of each year, which is our fiscal year end. Conducting the impairment test as of May 31 of each fiscal year aligns with our annual budget process which is typically completed during the fourth quarter of each year. In addition, performing our annual goodwill impairment test as of this date allows for a thorough consideration of the valuations of our business units subsequent to the completion of our annual budget process but prior to our financial year end reporting date. The annual impairment test for goodwill is a two-step process that involves comparing the estimated fair value of each business unit to the unit s carrying value, including goodwill. If the fair value of a business unit exceeds its carrying amount, the goodwill of the business unit is not considered impaired; therefore, the second step of the impairment test is unnecessary. If the carrying amount of a business unit exceeds its fair value, we would then perform a second step to the goodwill impairment test to measure the amount of goodwill impairment loss to be recorded. Consistent with prior years, the fair values of reporting units in fiscal years 2010 and 2009 were determined using a method based on discounted cash flow models with estimated cash flows based on internal forecasts of revenues and expenses over a four year period plus a terminal value period (the income approach). The income approach estimates fair value by discounting each reporting unit s estimated future cash flows using a discount rate that approximates both our weighted-average cost of capital and reflects current market conditions.

The fair value derived from the income approach in our most recent test for impairment, in the aggregate, approximated our market capitalization. At May 31, 2010, our market capitalization exceeded the carrying value of our consolidated net assets by approximately $121 million, or 73%, and the fair value of both our individual reporting units significantly exceeded their respective carrying amounts as of that date. Projected growth rates and other market inputs to our impairment test models, such as the discount rate, are sensitive to the risk of future variances due to market conditions as well as business unit execution risks. Consequently, if future results fall below our forward-looking projections for an extended period of time, the results of future impairment tests could indicate an impairment. Although we believe the cash flow projections in our income approach make reasonable assumptions about our business, a significant increase in competition or reduction in our competitive capabilities could have a significant adverse impact on our ability to retain market share and thus on the projected margins included in the income approach used to value our reporting units. We periodically review our projected growth rates and other market inputs used in our impairment test models as well as changes in our business and other factors that could represent indicators of impairment. Subsequent to our May 31, 2010 annual impairment test, no such indicators of impairment were identified.

There was $103.1 million and $55.7 million of goodwill at February 28, 2011 and May 31, 2010, respectively. For the nine months ended February 28, 2011, the primary change in goodwill is attributable to the acquisition of Quest Integrity Group, LLC (Quest Integrity) which added $45.3 million to goodwill, and to a lesser extent, foreign currency exchange rates and their effect on goodwill in foreign subsidiaries of both our divisions.

Table of Contents

	TCM Division	Nine Months Ended February 28, 2011 TMS Division	Total
Balance at beginning of period	$ 44,939	$ 10,800	$ 55,739
Acquisition and purchase price adjustments	44,533		44,533
Foreign currency adjustments	1,491	1,334	2,825
Balance at end of period	$ 90,963	$ 12,134	$ 103,097

Allowance for Doubtful Accounts. In the ordinary course of business, a percentage of our accounts receivable are not collected due to billing disputes, customer bankruptcies, dissatisfaction with the services we performed and other various reasons. We establish an allowance to account for those accounts receivable that will eventually be deemed uncollectible. The allowance for doubtful accounts is based on a combination of our historical experience and management s review of long outstanding accounts receivable.

Workers Compensation, Auto, Medical and General Liability Accruals. In accordance with ASC 450, *Contingencies* (ASC 450) we record a loss contingency when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. We review our loss contingencies on an ongoing basis to ensure that we have appropriate reserves recorded on our balance sheet. These reserves are based on historical experience with claims incurred but not received, estimates and judgments made by management, applicable insurance coverage for litigation matters, and are adjusted as circumstances warrant. For workers compensation, automobile liability and general liability claims, our self-insured retention is currently $500,000 per occurrence. Our historical claims occurring before June 1, 2009 had a lower self-insured retention, typically $250,000. For medical claims, our self-insured retention is $150,000 per individual claimant determined on an annual basis. For environmental liability claims, our self-insured retention is $100,000 per occurrence. We maintain insurance for claims that exceed such self-retention limits. The insurance is subject to terms, conditions, limitations and exclusions that may not fully compensate us for all losses. Our estimates and judgments could change based on new information, changes in laws or regulations, changes in management s plans or intentions, or the outcome of legal proceedings, settlements or other factors. If different estimates and judgments were applied with respect to these matters, it is likely that reserves would be recorded for different amounts.

Revenue Recognition. We determine our revenue recognition guidelines for our operations based on guidance provided in applicable accounting standards and positions adopted by the FASB or the Securities and Exchange Commission (the SEC). Most of our projects are short-term in nature and we predominantly derive revenues by providing a variety of industrial services on a time and material basis. For all of these services our revenues are recognized when services are rendered or when product is shipped and risk of ownership passes to the customer. However, due to various contractual terms with our customers, at the end of any reporting period, there may be earned but unbilled revenue that is accrued to properly match revenues with related costs. At February 28, 2011 and May 31, 2010, the amount of earned but unbilled revenue included in accounts receivable was $10.7 million and $8.6 million, respectively.

Concentration of Credit Risk. No single customer accounts for more than 10% of consolidated revenues.

Earnings Per Share. Basic earnings per share is computed by dividing net income available to Team shareholders by the weighted-average number of shares of common stock outstanding during the year. Diluted earnings per share is computed by dividing net income available to Team shareholders, less income or loss for the period attributable to the non-controlling interest, by the sum of, (1) the weighted-average number of shares of common stock outstanding during the period, (2) the dilutive effect of the assumed exercise of share-based compensation using the treasury stock method and (3) the dilutive effect of the assumed conversion of our non-controlling interest to our common stock (see Note 2).

Table of Contents

Amounts used in basic and diluted earnings per share, for all periods presented, are as follows (in thousands):

	Three Months Ended February 28,		Nine Months Ended February 28,	
	2011	2010	2011	2010
Weighted-average number of basic shares outstanding	19,342	18,954	19,114	18,913
Options on common stock, stock units and performance awards	852	667	684	578
Assumed conversion of non-controlling interest	209		116	
Total shares and dilutive securities	20,403	19,621	19,914	19,491

There were 652,000 and 789,000 options to purchase shares of common stock outstanding during the three month periods ended February 28, 2011 and 2010 excluded from the computation of diluted earnings per share because the options exercise prices were greater than the average market price of common shares during the periods. There were 777,000 and 830,000 options to purchase shares of common stock outstanding during the nine month periods ended February 28, 2011 and 2010 excluded from the computation of diluted earnings per share because the options exercise prices were greater than the average market price of common shares during the periods.

Foreign Currency. For subsidiaries whose functional currency is not the U.S. Dollar, assets and liabilities are translated at period ending rates of exchange and revenues and expenses are translated at period average exchange rates. Translation adjustments for the asset and liability accounts are included as a separate component of accumulated other comprehensive income in stockholders equity. Foreign currency transaction gains and losses are included in our statement of operations. Effective December 1, 2009, we began to account for Venezuela as a highly-inflationary economy and the effect of all subsequent currency fluctuations between the Bolivar and the U.S. Dollar are recorded in our statement of operations (see Note 14).

Newly Adopted Accounting Principles

ASC 810. In June 2009, the FASB issued an update to ASC 810, *Consolidations* (ASC 810) which amends the guidance applicable to variable interest entities. The amendments will significantly affect the overall consolidation analysis under ASC 810. The guidance is effective as of the beginning of the first fiscal year that begins after November 15, 2009. The adoption of this pronouncement did not have any impact on our results of operations, financial position or cash flows.

ASC 105. In June 2009, the FASB issued ASC 105, *Generally Accepted Accounting Principles* (ASC 105). ASC 105 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 GAAP. ASC 105 supersedes all previously existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in the Codification will become non-authoritative. ASC 105 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The adoption of this pronouncement did not have any impact on our results of operations, financial position or cash flows.

2. ACQUISITIONS

On November 3, 2010 we purchased Quest Integrity, a privately held advanced inspection services and engineering assessment company. We effectively purchased 95% of Quest Integrity for a total consideration paid to Quest Integrity shareholders of $41.7 million, consisting of a cash payment of $39.1 million and the issuance of our restricted common stock with a fair value of $2.6 million (approximately 186,000 shares). Additionally, we also assumed debt of Quest Integrity, payable to a bank, with a value of $2.3 million. We repaid the debt upon consummation of the purchase. In connection with this transaction, we borrowed $41.4 million under our credit facility which was used to fund the cash portion of the purchase price. We expect to purchase the remaining 5% in fiscal year 2015 for a purchase consideration based upon the future financial performance of Quest Integrity as defined in the purchase agreement. Future consideration would be payable in unregistered shares of our common stock for an aggregate value of no less than $2.4 million, provided the aggregate value of the consideration does not exceed 20% of our outstanding common stock. Our preliminary valuation of the remaining 5% equity of Quest Integrity at the date of acquisition is $4.9 million, which is reflected in the shareholders equity section of the Consolidated Balance Sheet as Non-controlling interest .

Headquartered near Seattle, Washington, Quest Integrity has leading technical capabilities related to the measurement and assessment of facility and pipeline mechanical integrity. Quest Integrity has developed several proprietary tools for advanced tube and pipeline inspection and measurement. Supporting and augmenting these proprietary inspection tools, Quest Integrity has an advanced technical team that provides specialized engineering assessments of facility conditions and serviceability. Quest Integrity maintains operations in Seattle, Boulder, and New Zealand, and has service locations in Houston, Calgary, Australia, The Netherlands, and the Middle East.

We are obtaining independent valuations of the tangible and intangible asset values of Quest Integrity, and the resulting residual goodwill, which we expect to be completed by May 31, 2011. We believe a significant portion of the purchase price is attributable to amortizable intangible assets. Accordingly, we have included $0.5 million of amortization expense for the three months ended February 28, 2011 and $0.7 million for the nine months ended February 28, 2011, in our results of operations to reflect estimated accumulated amortization of intangible assets. Information regarding the preliminary allocation of the purchase price is set forth below (in thousands):

	(unaudited)
Receivables	$ 5,687
Prepaid expenses and other current assets	505
Property, plant and equipment	1,831
Other assets	78
Assets acquired	8,101
Accounts payable	1,291
Other accrued liabilities	3,136
Liabilities assumed	4,427
Net assets acquired	$ 3,674
Bank debt assumed	$ 2,276
Cash paid to Quest Integrity shareholders	39,100
Restricted stock issued to Quest Integrity shareholders	2,635
Total purchase price	44,011
Estimated fair value of non-controlling interest	4,917
Fair value allocation	$ 48,928
Estimated intangibles	$ 22,627
Estimated goodwill	22,627
Unallocated purchase price	$ 45,254

Table of Contents

Information regarding the change in carrying value of the non-controlling interest is set forth below:

Estimated fair value of non-controlling interest at November 3, 2010	$ 4,917
Income attributable to non-controlling interest	9
Other comprehensive income attributable to non-controlling interest	
Estimated fair value of non-controlling interest at February 28, 2011	$ 4,926

3. TAX PROVISION

During the third quarter of fiscal year 2011, the Company identified and corrected accounting errors relating to the effect of share-based compensation on tax provisions for fiscal years 2007 through 2010 and the first two quarters of fiscal year 2011. During those periods, reported earnings were understated because effective tax rates were overstated as a result of the previously undetected errors in the tax provision calculation. No restatement of previously issued financial statements was required because the effect on those statements was immaterial. The cumulative effect of the errors in the tax provision calculation was a tax benefit, which was recorded in the current quarter, consisting of $1.8 million associated with the prior years and $0.5 million associated with the first two quarters of the current fiscal year.

The impact of the adjustment was determined not to be material to our results of operations, financial position or cash flows for the three and nine months ended February 28, 2011, nor to any of our previously issued financial statements for prior periods. This determination involved both quantitative assessments and qualitative assessments that considered, among many things;

- the adjustment had no impact on key operational GAAP measures such as revenues, gross margin or operating income,
- the non-cash nature of the adjustment,
- the adjustment had no impact on any banking covenants or key non-GAAP measures such as EBITDA,
- the adjustment had no impact on executive compensation in any period, and
- the adjustment had no quantitative material impact to any prior period.

Excluding the effect of the $1.8 million portion of the cumulative adjustments related to prior years, the Company s effective tax rate for fiscal year 2011 is expected to be 38% versus the 40% tax rate previously reported.

4. RECEIVABLES

A summary of accounts receivable as of February 28, 2011 and May 31, 2010 is as follows (in thousands):

	February 28, 2011 (unaudited)	May 31, 2010
Trade accounts receivable	$ 92,713	$ 105,714
Unbilled revenues	10,745	8,588
Allowance for doubtful accounts	(3,903)	(4,934)

Total	$	99,555	$	109,368

Table of Contents

5. INVENTORY

A summary of inventory as of February 28, 2011 and May 31, 2010 is as follows (in thousands):

	February 28, 2011 (unaudited)	May 31, 2010
Raw materials	$ 3,355	$ 2,988
Work in progress	541	528
Finished goods	16,966	16,217
Total	$ 20,862	$ 19,733

6. PROPERTY, PLANT AND EQUIPMENT

A summary of property, plant and equipment as of February 28, 2011 and May 31, 2010 is as follows (in thousands):

	February 28, 2011 (unaudited)	May 31, 2010
Land	$ 996	$ 964
Buildings and leasehold improvements	8,367	8,263
Machinery and equipment	101,295	91,091
Furniture and fixtures	1,668	1,357
Computers and computer software	7,114	5,987
Automobiles	2,728	2,404
Construction in progress	9,193	8,085
Total	131,361	118,151
Accumulated depreciation and amortization	(75,005)	(62,922)
Property, Plant and Equipment, net	$ 56,356	$ 55,229

At February 28, 2011, there was $0.4 million of capitalized interest included in property, plant and equipment attributable to 50 acres purchased in October 2007 to construct future facilities in Houston, Texas. At February 28, 2011, total capitalized cost of the project, inclusive of the capitalized interest, property purchase and related development cost was $6.8 million. Due to the 2008 economic recession, we postponed construction of the future facilities until such time as economic conditions and our growth necessitate the addition of the new facilities. Starting in the third quarter of fiscal year 2009, we ceased to further capitalize interest until the project resumes.

7. OTHER ACCRUED LIABILITIES

A summary of other accrued liabilities as of February 28, 2011 and May 31, 2010 is as follows (in thousands):

	February 28, 2011 (unaudited)	May 31, 2010
Payroll and other compensation expenses	$ 20,213	$ 13,521
Insurance accruals	4,621	5,253

Property, sales and other non-income related taxes	749

F - 1

Table of Contents

XSTREAM MOBILE SOLUTIONS CORP.
CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2007 AND 2006

ASSETS

	2007	2006
CURRENT ASSETS		
Cash and cash equivalents	$ 51,724	$ 178,421
FIXED ASSETS		
Equipment, net	4,105	5,209
OTHER CURRENT ASSETS		
Investment in Triex - Cost	10,000	-
TOTAL ASSETS	$ 65,829	$ 183,630

LIABILITIES AND STOCKHOLDERS' EQUITY

	2007	2006
LIABILITIES		
Accounts payable and accrued expenses	$ 23,357	$ 32,213
Short term advances	-	107,130
Total Liabilities	23,357	139,343
STOCKHOLDERS' EQUITY		
Preferred Stock Series A, $.001 Par Value; 990,000 shares authorized and none issued and outstanding	-	-
Preferred Stock Series B, $.001 Par Value; 9,000,000 shares authorized and none issued and outstanding	-	-
Preferred Stock Series C, $.001 Par Value; 10,000 shares authorized and none issued and outstanding	-	-
Common Stock $.001 Par Value; 90,000,000 shares authorized and 4,774,317 and 2,018,222 shares, respectively, issued and 4,379,465 and 1,623,370 shares, respectively outstanding	4,775	2,018
Additional Paid-in Capital	5,945,769	3,563,196
Accumulated Deficit	(5,610,767)	(3,221,622)
Stock subscription receivable	-	(2,000)
	339,777	341,592
Less: Cost of treasury stock, 394,852 shares	(297,305)	(297,305)
Total Stockholders' Equity	42,472	44,287
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 65,829	$ 183,630

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

Table of Contents

XSTREAM MOBILE SOLUTIONS CORP.
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006

	2007	2006
OPERATING REVENUES		
Revenue	$ 15,000	$ 5,850
OPERATING EXPENSES		
Depreciation	1,104	314
General and Administrative expenses	2,406,833	531,091
Total operating expenses	2,407,937	531,405
LOSS BEFORE OTHER INCOME (EXPENSES)	(2,392,937)	(525,555)
OTHER INCOME (EXPENSES)		
Interest income	3,792	-
Beneficial interest	-	(614,299)
Total other income (expense)	3,792	(614,299)
LOSS BEFORE PROVISION FOR INCOME TAXES	(2,389,145)	(1,139,854)
Provision for Income Taxes	-	-
NET LOSS APPLICABLE TO COMMON SHARES	$ (2,389,145)	$ (1,139,854)
NET LOSS PER BASIC AND DILUTED SHARES	$ (0.56)	$ (0.96)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	4,284,305	1,185,686

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

F - 3

Table of Contents

XSTREAM MOBILE SOLUTIONS CORP.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY (DEFCIT)
FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006

	Common Stock		Additional Paid-in	Accumulated	Treasury Stock		Stock subscription	Stockholders Equity
	Shares	Amount	Capital	Deficits	Shares	Amount	receivable	(Deficit)
Balance, September 30, 2005	773,000	$ 773	$ 2,039,550	$ (2,081,768)	299,852	$ (221,305)	$ -	$ (262,750)
Issuance of stock for the conversion of debt on January 6, 2006	440,625	441	880,809	-	-	-	-	881,250
July 24, 2006 Share repurchase	-	-	-	-	95,000	(76,000)	-	(76,000)
Sale of shares for cash	804,597	804	642,837	-	-	-	-	643,641
Stock subscription receivable							(2,000)	(2,000)
Net loss fiscal 2006	-	-	-	(1,139,854)	-	-	-	(1,139,854)
Balance, September 30, 2006	2,018,222	$ 2,018	$ 3,563,196	$ (3,221,622)	394,852	$ (297,305)	$ (2,000)	$ 44,287
Purchase Xstream Mobile	1,417,992	1,418	45,712					47,130
Issuance of stock for cash	98,603	99	88,101				$ 2,000	90,200
Issuance of stock for	720,000	720	2,189,280					2,190,000

services								
Issued of stock in exchange for Xstream Mobile Solutions, Inc.	407,000	407	(407)					-
Stock issued to satisfy prior liability	112,500	113	59,887					60,000
Net loss fiscal 2007				(2,389,145)				(2,389,145)
Balance, September 30, 2007	4,774,317	$ 4,775	$ 5,945,769	$ (5,610,767)	394,852	$ (297,305)	$ -	$ 42,472

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

Table of Contents

XSTREAM MOBILE SOLUTIONS CORP.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY (DEFCIT)
FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006

	2007	2006
CASH FLOW FROM OPERATING ACTIVITIES		
Net loss	$ (2,389,145)	$ (1,139,854)
Adjustments to reconcile net loss to net cash		
(used in) operating activities:		
Depreciation	1,104	314
Beneficial interest	-	614,299
Issuance of stock for services	2,190,000	-
Changes in assets and liabilities		
Increase (decrease) in accounts payable and		
accrued expenses	(8,856)	34,414
Total adjustments	2,182,248	649,027
Net cash (used in) operating activities	(206,897)	(490,827)
CASH FLOW FROM INVESTING ACTIVITIES		
Repurchase of stock	-	(76,000)
Purchase of equipment	-	(5,523)
Investment in Triex - Cost	(10,000)	-
Net cash (used in) investing activities	(10,000)	(81,523)
CASH FLOW FROM FINANCING ACTIVITIES		
Sale of common stock	-	643,641
Short term advances	-	107,130
Proceeds from issuance of common stock - warrants	90,200	-
Net cash provided by financing activities	90,200	750,771
NET INCREASE (DECREASE) IN		
CASH AND CASH EQUIVALENTS	(126,697)	178,421
CASH AND CASH EQUIVALENTS -		
BEGINNING OF YEAR	178,421	-
CASH AND CASH EQUIVALENTS - END OF YEAR	$ 51,724	$ 178,421
SUPPLEMENTAL DISCLOURE OF NON-CASH INFORMATION		
Stock issued for services	$ 2,190,000	-

Stock issued to retire accounts payable and accrued expenses	$	-	$	881,250
Acquistion of Xstream Mobile Solutions, Inc. :				
Due to Xstream Mobile Solutions, Inc.	$	107,130	$	-
Common Stock		(1,418)		-
Additional paid in capital		(45,712)		-
Liability for stock to be issued		(60,000)		-
	$	-	$	-

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

F - 5

Table of Contents

XSTREAM MOBILE SOLUTIONS CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2007 AND 2006

NOTE 1 - ORGANIZATION AND BASIS OF PRESENTATION

The Company was incorporated on May 10, 1998, under the laws of the State of Delaware. The business purpose of the Company was originally to engage in environmental monitoring and testing. However, on December 31, 2001, the Company liquidated those operating assets. The Company has adopted a fiscal year ending September 30.

On February 3, 2005 the Company changed its name to Netchoice, Inc. On December 19, 2005 the Company changed its name to Xstream Mobile Solutions Corp. On January 1, 2006 the Company began operations in software acquisition, development and marketing. The Company acquired a related company in October 2006 (see Note 6).

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents/Investments

The Company considers all highly liquid debt instruments and other short-term investments with an initial maturity of three months or less to be cash equivalents. There were no cash equivalents as of September 30, 2007 and September 30, 2006.

The Company maintains cash and cash equivalent balances at one financial institution that is insured by the Federal Deposit Insurance Corporation up to $250,000. At September 30, 2007, the Company had no funds in excess of the insured limit.

Investments are stated at cost.

Table of Contents

XSTREAM MOBILE SOLUTIONS CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTEMBER 30, 2007 AND 2006

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Revenue and Cost Recognition

Revenue is recognized under the accrual method of accounting when the services are rendered and the customer has been billed, rather than when cash is collected for the services provided. Specifically, the terms of the contracts call for a fixed set fees based on an hourly rate per individual.

Cost is recorded on the accrual basis as well, when the services are incurred rather than paid for.

Start-up Costs

In accordance with the American Institute of Certified Public Accountants Statement of Position 98-5, “Reporting on the Costs of Start-up Activities,” the Company expenses all costs incurred in connection with the start-up and organization of the Company.

Common Stock Issued for Other Than Cash

Services purchased and other transactions settled in the Company’s common stock are recorded at the estimated fair value of the stock issued if that value is more readily determinable than the fair value of the consideration received.

Equipment

The cost of office and computer equipment is capitalized and depreciated over its useful life using the straight-line method of depreciation. For all equipment presently owned the estimated useful life is 60 months. Repairs that substantially extend the useful life of the assets are capitalized and those that do not are charged to operations. Depreciation expense for the years ended September 30, 2007 and 2006 was $1,104 and $314, respectively.

Income Taxes

The income tax benefit is computed on the pretax loss based on the current tax law. Deferred income taxes are recognized for the tax consequences in future years of differences between the tax basis of assets and liabilities and their financial reporting amounts at each year-end based on enacted tax laws and statutory tax rates. The Company has not established a provision due to the losses sustained.

Table of Contents

XSTREAM MOBILE SOLUTIONS CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTEMBER 30, 2007 AND 2006

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Earnings (Loss) Per Share of Common Stock

Historical net (loss) per common share is computed using the weighted average number of common shares outstanding. Diluted earnings per share (EPS) include additional dilution from common stock equivalents, such as stock issuable pursuant to the exercise of stock options and warrants. Common stock equivalents were not included in the computation of diluted earnings per share when the Company reported a loss because to do so would be antidilutive for periods presented.

The following is a reconciliation of the computation for basic and diluted EPS:

	September 30, 2007	September 30, 2006
Net Loss	$ (2,389,145)	$ (1,139,854)
Weighted-average common shares outstanding (Basic)	4,284,305	1,185,686
Weighted-average common stock equivalents:		
Stock options	-	-
Warrants	-	-
Weighted-average common shares outstanding (Diluted)	4,284,305	1,185,686

Options and warrants outstanding to purchase stock were not included in the computation of diluted EPS because inclusion would have been antidilutive.

Table of Contents

XSTREAM MOBILE SOLUTIONS CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTEMBER 30, 2007 AND 2006

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Recent Accounting Pronouncements

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140." SFAS No. 155 resolves issues addressed in SFAS No. 133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets," and permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, establishes a requirement to evaluate interests in securitized Financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarify that concentrations of credit risk in the form of subordination are not embedded derivatives and amends SFAS No. 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of the first fiscal year that begins after September 15, 2006. The adoption of FAS 155 does not have a material impact on the Company's financial position, results of operations, or cash flows.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140." SFAS No. 156 requires an entity to recognize a servicing asset or liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract under a transfer of the servicer's financial assets that meets the requirements for sale accounting, a transfer of the servicer's financial assets to a qualified special-purpose entity in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities and classifies them as either available-for-sale or trading securities in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" and an acquisition or assumption of an obligation to service a financial asset that does not relate to financial assets of the servicer or its consolidated affiliates.

Additionally, SFAS No. 156 requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, permits an entity to choose either the use of an amortization or fair value method for subsequent measurements, permits at initial adoption a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights and requires separate presentation of servicing assets and liabilities subsequently measured at fair value and additional disclosures for all separately recognized servicing assets and liabilities. SFAS No. 156 is effective for transactions entered into after the beginning of the first fiscal year that begins after September 15, 2006. The adoption of FAS 156 does not have a material impact on the Company's financial position or results of operations.

Table of Contents

XSTREAM MOBILE SOLUTIONS CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTEMBER 30, 2007 AND 2006

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Recent Accounting Pronouncements (Continued)

In September 2006, the FASB issued SFAS No. 157 “Fair Value Measurements,” which provides a definition of fair value, establishes a framework for measuring fair value and requires expanded disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The provisions of SFAS No. 157 should be applied prospectively.

In February 2008, FASB Staff Position ("FSP") FAS No. 157-2, "Effective Date of FASB Statement No. 157" ("FSP No. 157-2") was issued. FSP No. 157-2 defers the effective date of SFAS No. 157 to fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Examples of items within the scope of FSP No. 157-2 are nonfinancial assets and nonfinancial liabilities initially measured at fair value in a business combination (but not measured at fair value in subsequent periods), and long-lived assets, such as property, plant and equipment and intangible assets measured at fair value for an impairment assessment under SFAS No. 144.

The partial adoption of SFAS No. 157 on January 1, 2008 with respect to financial assets and financial liabilities recognized or disclosed at fair value in the financial statements on a recurring basis did not have a material impact on the Company's financial statements. See Note 12 for the fair value measurement disclosures for these assets and liabilities. The Company is in the process of analyzing the potential impact of SFAS No. 157 relating to its planned January 1, 2009 adoption of the remainder of the standard.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans -- An Amendment of FASB Statements No. 87, 88, 106, and 132R." This standard requires an employer to: (a) recognize in its statement of financial position an asset for a plan's overfunded status or a liability for a plan's underfunded status; (b) measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year (with limited exceptions); and (c) recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes will be reported in comprehensive income. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008.

Table of Contents

XSTREAM MOBILE SOLUTIONS CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTEMBER 30, 2007 AND 2006

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Recent Accounting Pronouncements (Continued)

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of SFAS No. 115 ("SFAS No. 159"), which provides all entities, including not-for-profit organizations, with an option to report selected financial assets and liabilities at fair value. The objective of SFAS No. 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in earnings caused by measuring related assets and liabilities differently without having to apply the complex provisions of hedge accounting. Certain specified items are eligible for the irrevocable fair value measurement option as established by SFAS No. 159. SFAS No. 159 is effective as of the beginning of the Company's year beginning after January 1, 2008. The Company does not believe this statement will have a material impact on its financial position and results of operations upon adoption.

In December 2007, the FASB issued FAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements-an amendment of ARB No. 51" ("FAS No. 160"). FAS No. 160 establishes accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a non-controlling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. FAS No. 160 is effective for the Company in its fiscal year beginning January 1, 2010. The Company does not believe this statement will have a material impact on its financial position and results of operations upon adoption.

In December 2007, the FASB issued FAS No. 141 R "Business Combinations" ("FAS No. 141R"). FAS No. 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquire. FAS No. 141R also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. FAS No. 141R is effective for the Company's fiscal year beginning January 1, 2010.

Table of Contents

XSTREAM MOBILE SOLUTIONS CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTEMBER 30, 2007 AND 2006

NOTE 3- FIXED ASSETS

Fixed assets consisted of the following:

	September 30 2007	September 30 2006
Equipment	$ 5,523	$ 5,523
Less: Accumulated Depreciation	(1,418)	(314)
Fixed Assets - Net	$ 4,105	$ 5,209

NOTE 4 - STOCKHOLDERS' EQUITY

Preferred Stock

On December 3, 2004 the Company changed the number of Preferred Stock from one class of stock consisting of 10,000,000 shares with a par value of $0.01 to three separate series of preferred stock and changed the par value to $0.001. They are as follows:

Preferred Stock Series A

990,000 shares with a par value of $0.001 per share, participating, voting and convertible with a liquidation value of $1,000

Preferred Stock Series B

9,000,000 shares with a par value of $0.001 per share, participating; voting and convertible with a liquidation value of $3 each.

Preferred Stock Series C

10,000 shares with a par value of $0.001 per share, with a liquidation value of $10 each.

All preferred stock series A, B and C are convertible to 4,000 common shares as well as 4,000 votes for each share held. In addition, in all cases, the holders of the Preferred Stock C will vote cumulatively at least fifty-one percent (51%) of all votes cast regardless of the amount of series C shares issued, at any meeting of shareholders or any major issue put before the Company for voting of shareholders

Table of Contents

XSTREAM MOBILE SOLUTIONS CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTEMBER 30, 2007 AND 2006

NOTE 4 - STOCKHOLDERS' EQUITY (CONTINUED)

Common Stock

On December 3, 2004, the Company increased the authorized number of shares of common stock from 30,000,000 shares to 90,000,000 shares and also changed the par value from $0.01 to $0.001.

On January 31, 2006, the Company effectuated a reverse split of 1 for 8 shares of its common stock. The 89,709,000 shares issued became 11,213,625 issued with 10,913,772 shares outstanding.

As of September 30, 2006 there were 90,000,000 shares authorized, 2,018,222 shares issued and 1,623,370 shares outstanding of the Company's common stock with a par value of $0.001.

The Company issued 720,000 shares for services. The value was $2,190,000.

On October 9, 2006 the Company approved 1,417,992 shares of its common stock to acquire Xstream Mobile Solutions, Inc., an Illinois company. The Company acquired Xstream Mobile Solutions Inc. from a related party. An additional 407,000 shares were issued subsequently to complete the acquisition.

The company issued 98,603 shares for cash of $90,200.

The Company issued 112,500 shares of its common stock for prior Liability for stock to be issued valued at $60,000.

As of September 30, 2007, there were 90,000,000 shares authorized and 4,774,317 shares issued and 4,379,465 shares outstanding of the Company's common stock with a par value of $0.001.

Table of Contents

XSTREAM MOBILE SOLUTIONS CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
SEPTEMBER 30, 2007 AND 2006

NOTE 5 - INCOME TAXES

There was no income tax benefit recognized at September 30, 2007 and 2006.

The net deferred tax assets in the accompanying balance sheet include benefit of utilizing net operating losses of approximately $5,610,767 (at September 30, 2007). However due to the uncertainty of utilizing the net operating losses, an offsetting valuation allowance has been established.

NOTE 6 - RELATED PARTY TRANSACTIONS

On October 9, 2006 the Company approved 1,417,992 shares of its common stock to acquire Xstream Mobile Solutions, Inc., an Illinois company. The Company acquired Xstream Mobile Solutions Inc. from a related party. Under FASB 141 Business Combinations, when accounting for a transfer of assets or exchange of shares between entities under common control, the entity that receives the net assets or the equity interests shall initially recognize the assets and liabilities transferred at their carrying amounts in the accounts of the transferring entity at the date of transfer. An additional 407,000 shares were issued subsequently to complete the transaction.

Certain stockholders provide leased space to the Company for office and computer operations. The rental expense for the year ended September 30, 2007 and 2006 is $4,800 and $-0-, respectively.

An affiliated company of which a stockholder is a principal has contracted with the Company to provide programming services and technical communications support for its operations. The total charged to the Company for these services for the year ended September 30, 2007 and 2006 is $ 69,601 and $ -0-, respectively.

NOTE 7- GOING CONCERN

As shown in the accompanying consolidated financial statements, the Company incurred substantial net losses for the year ended September 30, 2007 and for the years ended September 30, 2006 and 2005, respectively. There is no guarantee whether the Company will be able to generate enough revenue and/or raise capital to support those operations. This raises substantial doubt about the Company's ability to continue as a going concern. Management believes the Company's capital requirement will depend on many factors, including the success of the Company to raise money. The Company continues to search for acquisition candidates to fund operations. The condensed financial statements do not include any adjustments that might result from the outcome of these uncertainties.

Table of Contents

Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized, this 7th day of May, 2009.

XSTREAM MOBILE SOLUTIONS CORP.,
a Delaware corporation

By:
Mike See
Chief Executive Officer

Each person whose signature appears below authorizes Mike See to execute in the name of each such person who is then an officer or director of the registrant, and to file, any amendments to this Annual Report on Form 10-K necessary or advisable to enable the registrant to comply with the Securities Exchange Act of 1934 and any rules, regulations and requirements of the Securities and Exchange Commission in respect thereof, which amendments may make such changes in such Report as such attorney-in-fact may deem appropriate.

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature and Title	Date
/s/ Michael See Mike See, Director, and Chief Executive Officer	May 12, 2009
/s/ Joseph Johns, III Joseph Johns, III, Director, President and Chief Financial Officer	May 12, 2009

- 22 -

Table of Contents

XSTREAM MOBILE SOLUTIONS CORP.

EXHIBIT INDEX
TO
2007 ANNUAL REPORT ON FORM 10-K

Exhibit Number	Description	Incorporated by Reference to:	Filed Herewith
31.1	Certificate of Michael See, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.		X
31.2	Certificate of Joseph Johns, III, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.		X
32.1	Certificate of Michael See, Chief Executive Officer, and Certificate of Jospeh Johns, III, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.		X