HCC INSURANCE HOLDINGS INC/DE/
Form 10-Q
December 27, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarter Ended June 30, 2006.

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from _______ to __________

Commission file number 001-13790

HCC Insurance Holdings, Inc.

(Exact name of registrant as specified in its charter)

Delaware	76-0336636
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
13403 Northwest Freeway, Houston, Texas	77040-6094
(Address of principal executive offices)	(Zip Code)

(713) 690-7300

(Registrant s telephone number, including area code)

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 o

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

Indicate the number of shares outstanding of each of the registrant s classes of common stock as of the latest practicable date.

On July 31, 2006, there were approximately 111.3 million shares of common stock, $1.00 par value issued and outstanding.

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Employment Agreement - John N. Molbeck, Jr.
Employment Agreement - Christopher L. Martin
Master Agreement
Certification by Chief Executive Officer
Certification by Chief Financial Officer
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EXPLANATORY NOTE LATE FILING OF QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2006

A Special Committee of our Board of Directors conducted an investigation of our past stock option granting practices and announced its findings on November 17, 2006. Because we did not know the financial impact of the Special Committee s investigation, we were not able to timely file our quarterly report on Form 10-Q for our second quarter ended June 30, 2006. We have completed calculating the financial effect utilizing the results of the investigation and are now filing this Form 10-Q for our second quarter. See Note 2 Restatement of Financial Statements of the notes to the Condensed Consolidated Financial Statements and Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations Restatement of Financial Statements, Special Committee and Company Findings for more information on the investigation and its financial effects.

This report on Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbors created by those laws. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements include information about possible or assumed future results of our operations. All statements, other than statements of historical facts, included or incorporated by reference in this report that address activities, events or developments that we expect or anticipate may occur in the future, including such things as growth of our business and operations, business strategy, competitive strengths, acquisitions, capital expenditures, goals, plans and references to future successes may be considered forward-looking statements. Also, when we use words such as anticipate, believe, estimate, expect, intend, plan, probably or similar expressions, we are making forward-looking statements.

Many risks and uncertainties may impact the matters addressed in these forward-looking statements, which could affect our future financial results and performance, including, among other things:

- *the effects of catastrophic losses;*
- *the cyclical nature of the insurance business;*
- *inherent uncertainties in the loss estimation process, which can adversely impact the adequacy of loss reserves;*
- *the effects of emerging claim and coverage issues;*
- *the effects of extensive governmental regulation of the insurance industry;*
- *potential credit risk with brokers;*
- *our increased retention of risk, which could expose us to greater potential losses;*
- *the adequacy of reinsurance protection;*
- *the ability or willingness of reinsurers to pay balances due us;*
- *the occurrence of terrorist activities;*
- *our ability to maintain our competitive position;*
- *changes in our assigned financial strength ratings;*
- *our ability to raise capital in the future;*

attraction and retention of qualified employees;

fluctuations in the fixed income securities market, which may reduce the value of our investment assets;

our ability to successfully expand our business through the acquisition of insurance-related companies;

our ability to receive dividends from our insurance company subsidiaries in needed amounts;

fluctuations in foreign exchange rates;

failures of our information technology systems, which could adversely affect our business;

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- *developments in the SEC s informal inquiry related to our past practices in connection with grants of stock options;*

- *potential issues related to the effects of Sections 409A and 162(m) of the Internal Revenue Code and any expenses associated therewith;*

- *changes to improve our internal controls related to the process of granting, documenting and accounting for stock option awards;*

- *additional expenses and taxes associated with our stock option investigation and related matters;*

- *potential litigation that could result from our stock option investigation;*

- *the ability of our Executive Officers to define and implement a strategic business plan; and*

- *our ability to cure all defaults or events of default under our outstanding loan agreements.*

These events or factors could cause our results or performance to differ materially from those we express in our forward-looking statements. Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of these assumptions, and, therefore, also the forward-looking statements based on these assumptions, could themselves prove to be inaccurate. In light of the significant uncertainties inherent in the forward-looking statements which are included in this report, our inclusion of this information is not a representation by us or any other person that our objectives and plans will be achieved.

Our forward-looking statements speak only at the date made and we will not update these forward-looking statements unless the securities laws require us to do so. In light of these risks, uncertainties and assumptions, any forward-looking events discussed in this report may not occur.

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HCC Insurance Holdings, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(unaudited, in thousands, except per share data)

	June 30, 2006	December 31, 2005
ASSETS		
Investments:		
Fixed income securities, at fair value (amortized cost: 2006 - $2,741,514; 2005 - $2,277,139)	$ 2,687,441	$ 2,268,624
Short-term investments, at cost, which approximates fair value	623,138	839,581
Other investments, at fair value (cost: 2006 - $242,526; 2005 - $144,897)	257,022	149,223
Total investments	3,567,601	3,257,428
Cash	44,342	73,935
Restricted cash and cash investments	167,073	170,978
Premium, claims and other receivables	896,983	884,654
Reinsurance recoverables	1,353,288	1,361,983
Ceded unearned premium	238,281	239,416
Ceded life and annuity benefits	72,782	73,415
Deferred policy acquisition costs	177,982	156,253
Goodwill	531,760	532,947
Other assets	321,559	277,791
Total assets	$ 7,371,651	$ 7,028,800
LIABILITIES		
Loss and loss adjustment expense payable	$ 2,918,441	$ 2,813,720
Life and annuity policy benefits	72,782	73,415
Reinsurance balances payable	154,248	176,954
Unearned premium	910,188	807,109
Deferred ceding commissions	67,325	67,886
Premium and claims payable	735,120	753,859
Notes payable	337,274	309,543
Accounts payable and accrued liabilities	345,675	335,879
Total liabilities	5,541,053	5,338,365
SHAREHOLDERS EQUITY		
Common stock, $1.00 par value; 250.0 million shares authorized (shares issued and outstanding: 2006 111,253; 2005 110,803)	111,253	110,803
Additional paid-in capital	778,128	762,170
Retained earnings	947,211	798,388
Accumulated other comprehensive income (loss)	(5,994)	19,074
Total shareholders equity	1,830,598	1,690,435

Total liabilities and shareholders equity	$ 7,371,651	$ 7,028,800

See Notes to Condensed Consolidated Financial Statements.

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HCC Insurance Holdings, Inc. and Subsidiaries
Condensed Consolidated Statements of Earnings
(unaudited, in thousands, except per share data)

	Six months ended June 30, 2006	Six months ended June 30, 2005 (As restated)	Three months ended June 30, 2006	Three months ended June 30, 2005 (As restated)
REVENUE				
Net earned premium	$ 783,891	$ 657,843	$ 403,320	$ 337,726
Fee and commission income	65,547	68,926	33,878	37,303
Net investment income	72,754	45,041	36,173	22,700
Net realized investment gain (loss)	(1,497)	2,000	(199)	2,003
Other operating income	38,795	9,252	20,045	5,105
Total revenue	959,490	783,062	493,217	404,837
EXPENSE				
Loss and loss adjustment expense, net	453,092	384,164	231,025	198,189
Policy acquisition costs, net	152,809	121,988	76,577	60,843
Other operating expense	97,002	95,871	49,669	50,194
Interest expense	4,437	3,778	2,283	1,970
Total expense	707,340	605,801	359,554	311,196
Earnings before income tax expense	252,150	177,261	133,663	93,641
Income tax expense	83,864	58,517	44,519	30,285
Net earnings	$ 168,286	$ 118,744	$ 89,144	$ 63,356
Basic earnings per share data:				
Net earnings per share	$ 1.51	$ 1.14	$ 0.80	$ 0.60
Weighted average shares outstanding	111,117	104,106	111,218	104,962
Diluted earnings per share data:				
Net earnings per share	$ 1.44	$ 1.11	$ 0.76	$ 0.59
Weighted average shares outstanding	116,885	107,042	116,860	108,269
Cash dividends declared, per share	$ 0.175	$ 0.132	$ 0.100	$ 0.075

See Notes to Condensed Consolidated Financial Statements.

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HCC Insurance Holdings, Inc. and Subsidiaries
Condensed Consolidated Statement of Changes in Shareholders Equity
Six months ended June 30, 2006
(unaudited, in thousands, except per share data)

	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Total shareholders equity
Balance at December 31, 2005	$ 110,803	$ 762,170	$ 798,388	$ 19,074	$ 1,690,435
Net earnings			168,286		168,286
Other comprehensive loss				(25,068)	(25,068)
Comprehensive income					143,218
Issuance of 450 shares for exercise of options, including tax benefit of $2,264	450	9,210			9,660
Stock-based compensation		6,748			6,748
Cash dividends declared, $0.175 per share			(19,463)		(19,463)
Balance at June 30, 2006	$ 111,253	$ 778,128	$ 947,211	$ (5,994)	$ 1,830,598

See Notes to Condensed Consolidated Financial Statements.

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HCC Insurance Holdings, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(unaudited, in thousands)

	Six months ended June 30,		Three months ended June 30,	
	2006	2005 (As restated)	2006	2005 (As restated)
Cash flows from operating activities:				
Net earnings	$ 168,286	$ 118,744	$ 89,144	$ 63,356
Adjustments to reconcile net earnings to net cash provided by operating activities:				
Change in premium, claims and other receivables	(10,298)	(90,611)	(54,660)	41,597
Change in reinsurance recoverables	8,695	(19,014)	(3,937)	(18,190)
Change in ceded unearned premium	1,135	45,861	1,249	(1,357)
Change in loss and loss adjustment expense payable	104,721	124,887	80,946	75,036
Change in reinsurance balances payable	(22,706)	(39,650)	4,351	(20,868)
Change in unearned premium	103,079	25,536	84,813	42,378
Change in premium and claims payable, net of restricted cash	(17,222)	15,536	13,096	(84,339)
Change in trading portfolio	(84,491)	(38,054)	(36,497)	3,274
Depreciation and amortization expense	7,644	7,360	3,819	3,650
Stock-based compensation expense	6,090	1,170	3,387	573
Other, net	(4,992)	(32,928)	(3,861)	(20,182)
Cash provided by operating activities	259,941	118,837	181,850	84,928
Cash flows from investing activities:				
Sales of fixed income securities	164,097	114,770	98,443	59,089
Maturity or call of fixed income securities	117,698	98,468	58,472	66,218
Cost of securities acquired	(791,385)	(498,144)	(319,771)	(221,144)
Change in short-term investments	218,856	181,716	(27,894)	36,691
Sale of strategic investment	17,363			
Payments for purchase of subsidiaries, net of cash received	(37,457)	(34,881)	(13,457)	(34,881)
Other, net	(5,097)	(11,378)	(3,050)	(10,260)
Cash used by investing activities	(315,925)	(149,449)	(207,257)	(104,287)
Cash flows from financing activities:				
Issuance of notes payable	39,000	33,000	28,000	33,000
Payments on notes payable	(11,249)	(14,465)	(142)	(14,372)
Sale of common stock	9,660	28,837	2,022	7,750
Dividends paid	(16,648)	(11,716)	(8,338)	(5,933)
Other	5,628	(3,814)	(2,904)	
Cash provided by financing activities	26,391	31,842	18,638	20,445

Net increase (decrease) in cash	(29,593)	1,230	(6,769)	1,086
Cash at beginning of period	73,935	69,933	51,111	70,077
Cash at end of period	$ 44,342	$ 71,163	$ 44,342	$ 71,163

See Notes to Condensed Consolidated Financial Statements.

HCC Insurance Holdings, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(unaudited, tables in thousands, except per share data)

(1) GENERAL INFORMATION

HCC Insurance Holdings, Inc. and its subsidiaries (collectively, we, us or our) include domestic and foreign property and casualty and life insurance companies, underwriting agencies and reinsurance brokers. We provide specialized property and casualty, surety, and group life, accident and health insurance coverages and related agency and reinsurance brokerage services to commercial customers and individuals. We market our products both directly to customers and through a network of independent brokers, producers and agents. Our lines of business include diversified financial products (which includes directors and officers liability, professional indemnity, employment practices liability and surety); group life, accident and health; aviation; London market account (which includes energy, marine, property, and accident and health); and other specialty lines of insurance. We operate primarily in the United States, the United Kingdom, Spain and Bermuda, although some of our operations have a broader international scope.

Basis of Presentation

Our unaudited condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (generally accepted accounting principles) and include the accounts of HCC Insurance Holdings, Inc. and its subsidiaries. We have made all adjustments that, in our opinion, are necessary for a fair presentation of results of the interim periods, and all such adjustments are of a normal recurring nature. All significant intercompany balances and transactions have been eliminated in consolidation. The condensed consolidated financial statements should be read in conjunction with our annual audited consolidated financial statements and related notes. The condensed consolidated balance sheet at December 31, 2005 was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles.

Management must make estimates and assumptions that affect amounts reported in our financial statements and in disclosures of contingent assets and liabilities. Ultimate results could differ from those estimates. We have reclassified certain amounts in our 2005 condensed consolidated financial statements to conform to the 2006 presentation. The reclassifications included the elimination of certain intercompany premium receivable and premium payable balances and reclassification of the corresponding lines in our 2005 condensed statements of cash flows. None of these reclassifications had an effect on our consolidated net earnings, shareholders equity or cash flows.

During 2006 and 2005, we completed several acquisitions. The results of operations of the acquired entities are included in our condensed consolidated financial statements beginning on the effective date of each acquisition. Thus, our condensed consolidated statements of earnings and cash flows for the six months and three months ended June 30, 2006 and 2005 do not contain any operations of the entities acquired in 2006 or 2005 prior to their acquisition date.

Income Tax

For the six months ended June 30, 2006 and 2005, the income tax provision was calculated based on an estimated effective tax rate for each fiscal year. Our effective tax rate differs from the United States Federal statutory rate primarily due to tax-exempt municipal bond interest, state income taxes and a special $1.8 million U.S. repatriation tax benefit in 2005.

HCC Insurance Holdings, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(unaudited, tables in thousands, except per share data)

Recent Accounting Change

The Financial Accounting Standards Board (FASB) has issued FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*. Effective January 1, 2007, FIN 48 clarifies the accounting for uncertain income tax positions. We are currently reviewing the requirements of FIN 48 to determine the effect it will have on our consolidated financial statements.

The FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which clarified the definition of fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurement. SFAS 157 does not require any new fair value measurements and eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 will be effective for us on January 1, 2008. We are currently assessing whether the adoption of SFAS 157 will have an impact on our consolidated financial statements.

The Securities and Exchange Commission has issued Staff Accounting Bulletin (SAB) No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB 108 establishes a standard approach for quantifying the materiality of errors to current and prior period financial statements. SAB 108 s guidelines must be applied in the fourth quarter, and adjustments, if any, will be recorded either by restating prior year financial statements or recording a cumulative effect adjustment as of January 1, 2006. We believe the requirements of SAB 108 will have no effect on our consolidated financial statements.

(2) RESTATEMENT OF FINANCIAL STATEMENTS

In light of published reports concerning the pricing of stock options and the timing of stock option grants at numerous other companies, in the second quarter of 2006 we undertook a voluntary internal review of our past practices related to grants of stock options. The voluntary review by our management concluded that the actual accounting measurement dates for certain past stock option grants differed from the originally stated grant dates, which were also utilized as the measurement dates for such awards. In August 2006, our Board of Directors formed a Special Committee of independent directors to commence an investigation of our past stock option granting practices for the period 1995 through 2005. The Special Committee was composed of the members of the Audit Committee of the Board of Directors. The Special Committee retained the law firm of Skadden, Arps, Slate, Meagher & Flom, LLP as its independent legal counsel and LECG as forensic accountants to aid in the investigation.

On November 17, 2006, we announced that the Special Committee had made certain determinations as a result of its review of our past stock option granting practices. The Special Committee found that we had used incorrect accounting measurement dates for stock option grants covering a significant number of employees and members of our Board of Directors during the period 1997 through 2005 and that certain option grants were retroactively priced. Additionally, at the direction of the Special Committee, we reviewed our stock option granting practices from 1992, the year of our initial public stock offering, through 1994 and in 2006 and found incorrect measurement dates due to retroactive pricing were used in 2006. In substantially all of these instances, the price on the actual measurement date was higher than the price on the stated grant date; thus recipients of the options could exercise at a strike price lower than the actual measurement date price. To determine the actual measurement dates, the Special Committee utilized the following sources of information:

The dates on documentation such as e-mails, regulatory form filings, acquisition agreements and other correspondence;

HCC Insurance Holdings, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(unaudited, tables in thousands, except per share data)

The date that the relevant stock option grant was entered into Equity Edge, our stock option tracking and accounting system;

Requirements of Accounting Principles Board (APB) No. 25, *Accounting for Stock Issued to Employees*, and related interpretations; and

Guidance from the Office of Chief Accountant of the Securities and Exchange Commission (SEC) contained in a letter dated September 19, 2006.

The Special Committee concluded that mis-priced option grants, the effect of which, together with certain other adjustments, resulted in a cumulative net decrease in shareholders equity at December 31, 2005 of $3.3 million, affected all levels of employees. The Special Committee found that Stephen L. Way, Chief Executive Officer, retroactively priced options, that he should have known he was granting options in a manner that conflicted with our stock option plans and public statements, and that this constituted a failure to align the stock option granting process with our stock option plans and public statements. Although finding his actions were inconsistent with the duties and obligations of a chief executive officer of a publicly-traded company, the Special Committee also found that Mr. Way s motivation appeared to be the attraction and retention of talent and to provide employees with the best option price. The Special Committee also concluded that Christopher L. Martin, Executive Vice President and General Counsel, was aware that options were being retroactively priced in a manner inconsistent with applicable plan terms and the procedures memoranda that he had prepared, that granting in-the-money options had accounting implications, and that he did not properly document our Compensation Committee s informal delegation of authority to Mr. Way. The Special Committee also found that there was no evidence that Mr. Way or Mr. Martin intended to falsify the consolidated financial statements.

Before the Board of Directors reviewed the results of the investigation, the Chairman of the Compensation Committee tendered his resignation from the Board of Directors on November 8, 2006. After reviewing the results of the investigation, the Board of Directors determined that it would be appropriate to accept the resignations of Mr. Way and Mr. Martin, which both tendered on November 17, 2006. Mr. Way will remain a director of HCC and serve as the non-executive Chairman of the Board of Directors and has entered into a consulting agreement with us to assist in the transition of leadership and to provide strategic guidance. We have entered into agreements with Mr. Way and Mr. Martin which, among other things, require them to disgorge an amount equal to the difference between the actual measurement date prices determined by HCC and the prices at which these individuals exercised mis-priced options since 1997.

HCC Insurance Holdings, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(unaudited, tables in thousands, except per share data)

As a result of the determinations of the Special Committee and because the resulting cumulative charge would be material to the second quarter and full year 2006 consolidated net earnings, we concluded that we needed to amend our 2005 Annual Report filed with the SEC on Form 10-K and our first quarter 2006 quarterly report filed with the SEC on Form 10-Q, to restate our consolidated financial statements and disclosures. The amended Forms 10-K/A and 10-Q/A have been filed with the SEC. We made the restatement in accordance with generally accepted accounting principles to record the following:

Non-cash compensation expense for the difference between the stock price on the stated grant date and the actual measurement date and for the fluctuations in stock price in certain instances where variable accounting should have been applied.

Other minor adjustments that were not recorded in the originally filed financial statements due to their immateriality. These minor adjustments primarily relate to fee and commission income, loss and loss adjustment expense, policy acquisition costs and other operating expense. In addition, balance sheet reclassifications have been recorded to appropriately present certain reinsurance recoverables and payables.

Related tax effects associated with the recognition of non-cash compensation expense and other adjustments as well as additional taxes that may be due and payable.

We have not amended any of our other previously filed annual reports on Form 10-K or quarterly reports on Form 10-Q for the periods affected by the restatement other than noted above. For this reason, the consolidated financial statements and related financial information contained in such previously filed reports should no longer be relied upon.

We were unable to timely file our quarterly reports on Form 10-Q for the quarters ended June 30, 2006 and September 30, 2006, primarily due to not knowing the financial impact of the Special Committee s investigation. We have also restated the June 30, 2005 and September 30, 2005 financial statements included in our quarterly reports on Form 10-Q for the respective 2006 quarters.

Based on the determinations of the Special Committee and our voluntary internal review, we identified a number of occasions during the period 1997 through 2005 and into 2006 on which we used an incorrect measurement date for financial accounting and reporting purposes for options granted. In accordance with Accounting Principles Board (APB) No. 25, *Accounting for Stock Issued to Employees*, and its related interpretations, we should have recorded compensation expense related to these options for the excess of the market price of our stock on the actual measurement date over the exercise price of the option. For periods commencing January 1, 2006, compensation expense is being recognized in accordance with Statement of Financial Accounting Standards (SFAS) No. 123(R) (revised), *Share-Based Payment*. However, we determined an incremental amount related to the mis-priced options must be recorded.

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(unaudited, tables in thousands, except per share data)

The types of errors identified were as follows:

We determined that many block grants to employees during the period 1997 throuD VALIGN="bottom" WIDTH="3%">	2002 2001 2000	$ 780,000(2) $ 200,000		3,000,000(2)
Charles Bradshaw (CEO since August 2002)	2002 2001 2000		500,000	
Terry Hanson (Chief Operating Officer and President since August 2002)	2002 2001 2000	$ 100,000	(3)	

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(1) All options were granted under the 2000 Stock Option Plan which was adopted in April 2000.

(2) Prior to his termination, Mr. Miller was prepaid $480,000 for services to be rendered from July 1, 2002 through April 30, 2003. The Company believes that, because Mr. Miller was terminated for cause on July 25, 2002, he was not entitled to substantially all of such amount. The Company also believes that because Mr. Miller was terminated for cause, the options for 3,000,000 shares of Common Stock have terminated. See Item 12. Certain Relationships and Related Transactions Transactions with William G. Miller.

(3) Mr. Hanson also received a standard package of medical, dental and life insurance, vacation and other benefits, the aggregate amount of which did not exceed 10% of the total annual salary and bonus reported for Mr. Hanson.

Director Compensation

Directors are currently paid $1,500 for each quarterly board meeting they attend plus actual expenses incurred for meeting attendance. Upon the initial election of the Board, each Director received options to purchase 500,000 shares of Common Stock at an exercise price of $1.00 per share as founder shares.

Effective October 1, 2003, all Directors who are not full-time salaried employees of the Company will receive a $20,000 annual retainer fee, $1,500 per board meeting attended in person and $750 for board meeting attended by conference call, and an additional $750 per member for committee meeting not held on the same day as board meetings and calls.

Employment Agreements

See the discussion in Item 12. Certain Relationships and Related Transactions regarding the employment agreement between the Company and William G. Miller.

Item 11. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

The following table indicates all persons who, as of March 20, 2003, the most recent practicable date, are known by the Company to own beneficially more than 5% of any class of the Company s outstanding voting securities. As of March 20, 2003, there were 63,476,312 shares of the Company s common stock outstanding. Except as otherwise indicated below, to the best of the Company s knowledge, each person named in the table has sole voting and investment power with respect to the securities beneficially owned by them as set forth opposite their name.

Security Ownership of Certain Beneficial Owners

TITLE OF CLASS	NAME AND ADDRESS OF BENEFICIAL OWNER	AMOUNT AND NATURE OF BENEFICIAL OWNER	% OF CLASS
Common	Westlake Holdings, LLC 800 West Main Street Lake City, SC 29560	5,998,800(1)	9.18%
Common	Piedmont Orange Investments, LLC 800 West Main Street Lake City, SC 29560	4,490,500(2)	6.92%
Common	VenCap Opportunities Fund, L.P. 125 Townpark Drive, Suite 300 Kennesaw, GA 30144	4,340,000(3)	6.71%
Common	VFTC FBO Wendell M. Starke, IRA 4300 Paces Ferry Road, Suite 500 Atlanta, GA 30339	3,360,000(4)	5.12%

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TITLE OF CLASS	NAME AND ADDRESS OF BENEFICIAL OWNER	AMOUNT AND NATURE OF BENEFICIAL OWNER	% OF CLASS
Common	Bill Bradshaw 2805 Millwood Avenue Columbia, SC 29205	3,212,500(5)	5.06%
Common	William G. Miller 5025 Harrington Road Alpharetta, GA 30022	8,900,000(6)	13.00%

(1) Includes Class A warrant for 1,875,000 shares of Common Stock.

(2) Includes Class A warrant for 1,425,000 shares of Common Stock.

(3) Includes Class A warrant for 1,200,000 shares of Common Stock.

(4) Includes Class A warrant for 1,050,000 shares of Common Stock.

(5) Bill Bradshaw is the son of Charles Bradshaw.

(6) Includes warrant for 2,000,000 shares of Common Stock and options for 3,000,000 shares of Common Stock which were granted pursuant to an employment agreement with the Company. Because Mr. Miller was terminated for cause effective July 25, 2002, the Company believes that the options for 3,000,000 shares of Common Stock have terminated. See Item 12. Certain Relationships and Related Transactions Transactions with William G. Miller.

Security Ownership Of Management

The following table indicates the beneficial ownership of the Company s voting securities of all Directors of the Company and all Executive Officers who are not Directors of the Company, and all officers and directors as a group, as of March 20, 2003, the most recent practicable date. As of March 20, 2003, there were 63,476,312 shares of the Company s outstanding Common Stock. Except as otherwise indicated below, to the best of the Company s knowledge, each person named in the table has sole voting and investment power with respect to the securities beneficially owned by them as set forth opposite their name. All options are currently exercisable, unless otherwise indicated. The address of each person named below, unless otherwise indicated, is 13801 Reese Blvd. West, Suite 150, Huntersville, North Carolina.

TITLE OF CLASS	NAME AND ADDRESS OF BENEFICIAL OWNER	AMOUNT AND NATURE OF BENEFICIAL OWNER	% OF CLASS

Common	Robert Wussler	2,300,000(1)	3.54%
Common	Terry Washburn	650,000(2)	1.01%
Common	Cale Yarborough	1,045,000(3)	1.63%
Common	Danny Ford	665,000(4)	1.04%
Common	Charles Bradshaw	2,900,000(5)	4.49%
Common	Terry Hanson	0	0

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TITLE OF CLASS	NAME AND ADDRESS OF BENEFICIAL OWNER	AMOUNT AND NATURE OF BENEFICIAL OWNER	% OF CLASS
Common	William G. Miller(6)	8,900,000(6)	13.00%
	5025 Harrington Road		
	Alpharetta, GA 30022		
Common	Jay Klompmaker	250,000(7)	0.39%
Common	All officers and directors as a group (8 persons)	14,900,000	20.47%

(1) All shares shown are owned by Mr. Wussler directly, except shares underlying options for 1,500,000 shares granted by the Company.

(2) All shares shown as owned by Dr. Washburn underlie options granted by the Company.

(3) All shares shown are owned by Mr. Yarborough directly, except shares underlying options for 500,000 shares granted by the Company.

(4) All shares shown as owned by Mr. Ford underlie options granted by the Company, except 165,000 shares which is Mr. Ford s share of a partnership of which he is a member.

(5) All shares except for 500,000 shares under options granted by the Company are owned by Bradshaw Investments, Inc., which is owned and controlled by Mr. Bradshaw. This amount also includes Class A warrants for 650,000 shares.

(6) All shares shown are owned by Mr. Miller directly, except shares underlying options for 3,000,000 shares granted by the Company. This amount also includes Class A warrants for 2,000,000 shares. Because Mr. Miller was terminated for cause effective July 25, 2002, the Company believes that the options for 3,000,000 shares of Common Stock have terminated. See Item 12. Certain Relationships and Related Transactions Transactions with William G. Miller.

(7) All shares shown as owned by Mr. Klompmaker underlie options for 250,000 shares granted by the Company.

Equity Compensation Plan Information

This table provides certain information as of December 31, 2002 with respect to our equity compensation plan:

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PLAN CATEGORY	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders*	6,400,000	$ 0.99	1,100,000
Equity compensation plans not approved by security holders	0	N/A	0
Total	6,400,000	$ 0.99	1,100,000

*All options are granted under the Company s 2000 Stock Option Plan, which authorizes the grant of options to purchase an aggregate of 3,000,000 shares and was approved by stockholders in April 2001. In 2001, the Board of Directors approved the increase of authorized shares available under the Plan to 7,500,000 shares. This increase in authorized shares will be submitted to a vote of the stockholders at the next annual meeting.

See Note 9 to the Consolidated Financial Statements for further information concerning our equity compensation plan.

Item 12. ***Certain Relationships and Related Transactions***

In July 2000, the Company entered into a bridge loan with a former Chief Executive Officer of the Company, David Wilkerson, to purchase the officer s principal residence. The residence and 533,000 shares of Company stock collateralized the amount loaned of $226,895. During the term of the loan, monthly payments of $1,647, including interest at 8.25%, were due with a balloon payment due on January 17, 2001. The loan was repaid in full in April 2001.

Transactions with William G. Miller

Employment Agreement. William G. Miller became an employee of the Company on September 4, 2001. On October 10, 2001, Mr. Miller was appointed by the Board of Directors as the Chief Executive Officer and a director of the Company. Effective January 1, 2002 (the Effective Date), the Company entered into an Employment Agreement (the Miller Employment Agreement) with Mr. Miller, which set forth the terms of his employment as Chief Executive Officer.

The Miller Employment Agreement provided that Mr. Miller would be employed for a period of 16 months from the Effective Date, unless earlier terminated. Mr. Miller was entitled to receive compensation as follows:

(a) Base salary of $50,000 per month (the Base Salary);

(b) An option to purchase 2,500,000 shares of the Company s Common Stock, which vested immediately at an exercise price of $0.35 per share (the CEO Option);

(c) An option to purchase 500,000 shares of the Company s Common Stock, as a result of his being appointed to the Board of Directors, at an exercise price of $1.00 per share and which vested immediately (the Director Option);

(d) The right to participate in the Company s various employee benefit plans, to be reimbursed for typical business expenses, and to receive various standard benefits; and

(e) In the event that TRAC began its first race with a minimum of eight racing teams by July 1, 2003 (the Bonus Event) and Mr. Miller was employed by the Company for a period of 12 months as its Chief Executive Officer, then

(i) A cash bonus in the amount of $1,000,000 (the Cash Bonus), and

(ii) an option to purchase 1,000,000 shares of the Company s Common Stock that would vest upon the occurrence of the Bonus Event (the Bonus Option).

In the event that Mr. Miller had exercised his right to terminate his employment or he was terminated without cause, he would be entitled to act as an independent consultant to the Company and to receive $50,000 per month as payment for those services until April 30, 2003.

The Miller Employment Agreement prohibits Mr. Miller, during the term of his employment and for the two-year period following termination of his employment, without the prior consent of the Board of Directors, from (i) soliciting customers or clients of the Company for the purpose of providing services to them, or (ii) soliciting employees or independent contractors of the Company for employment or services. Mr. Miller also is prohibited from competing with the Company, without the prior written consent of the Board of Directors, during the term of his employment and for the two-year period following his termination.

The Company terminated Mr. Miller s employment effective July 25, 2002 (the Termination Date). In accordance with the terms of the Miller Employment Agreement, Mr. Miller already had received advance payment of his Base Salary through April 30, 2003. Because Mr. Miller was not employed for a period of 12 months as the Chief Executive Officer and because the Bonus Event is not expected to occur, management believes that the Bonus Option and the Cash Bonus will not vest. Moreover, the Company contends that Mr. Miller s employment was terminated for cause and that, as a result, the CEO Option and Director Option are terminated and the Base Salary was not earned after the Termination Date.

Mr. Miller has disputed the Company s contention that he was terminated for cause. The Company has attempted without success to negotiate a resolution of this matter with Mr. Miller.

Atlanta Team Operating Rights. With the knowledge and approval of the Board of Directors, the Company entered into a nonbinding Agreement in Principle with Mr. Miller (AIP No. 1) pursuant to which it agreed to negotiate with Mr. Miller to finalize definitive agreements for Mr. Miller

to obtain operating rights to the Atlanta TRAC team (the Atlanta Team) for a purchase price of $10,000,000. AIP No. 1 was dated June 19, 2001 and was accepted and agreed to by Mr. Miller on August 8, 2001. Subsequently, the Company began negotiations with Mr. Miller to employ him as the Chief Executive Officer. With the knowledge and approval of the Board of Directors, the Company reduced the Atlanta Team purchase price in connection with Mr. Miller s overall employment package with the Company. The Company believes that a definitive agreement will not be executed by April 30, 2003, and therefore, AIP No. 1 will expire in accordance with its terms.

A second Agreement in Principle (AIP No. 2) on the same subject, dated August 25, 2001 was executed apparently on or about December 11, 2001, by Mr. Miller and Jon Pritchett, purportedly acting on behalf of the Company as its Chief Operating Officer. The Company contends that AIP No. 2 differs from AIP No. 1 in material respects that were not approved by the Board of Directors, that its execution was not authorized by the Company, and that it is void. Mr. Miller maintains that AIP No. 2 is an enforceable obligation of the Company. The Company has attempted without success to negotiate a resolution of this matter with Mr. Miller.

Payments to Robert Wussler

In May 2001, the Company and Robert J. Wussler, the Chairman of the Board, entered into an agreement pursuant to which Mr. Wussler agreed to assist the Company in obtaining a national television contract and to join the Board of Directors. The Company agreed to pay Mr. Wussler certain fees and to grant certain options to purchase shares of Common Stock. The Company and Mr. Wussler have agreed to terminate this agreement in exchange for a grant on April 12, 2003 of options to purchase 2,250,000 shares (immediately exercisable) at an exercise price of $1.00 per share. Mr. Wussler received $70,833.39 under the agreement prior to its termination. Mr. Wussler is not entitled to any further payments under this Agreement. Mr. Wussler will continue to serve as the Chairman of the Board.

Cale Yarborough Consulting Agreement

Mr. Yarborough, a Director, also serves as TRAC s national spokesman. For his duties as national spokesman, Mr. Yarborough receives $150,000 annually.

Item 13. ***Exhibits and Reports on Form 8-K***

(a) Exhibits See Exhibit Index at Page 23.

(b) Reports on Form 8-K There were two reports filed on Form 8-K during the quarter ended December 31, 2002:

(1) Current Report on Form 8-K dated December 11, 2002 of Team Sports Entertainment, Inc. filed with the Securities and Exchange Commission on December 18, 2002.

(2) Current Report on Form 8-K/A dated December 11, 2002 of Team Sports Entertainment, Inc. filed with the Securities and Exchange Commission on January 2, 2003.

Pursuant to General Instruction B of Form 8-K, any reports previously or in the future submitted under Item 9 are not deemed to be filed for the purpose of Section 18 of the Securities Exchange Act of 1934 and the Company is not subject to the liabilities of that section. The Company is not incorporating, and will not incorporate, by reference these reports into a filing under the Securities Act of 1933, as amended, or the Exchange Act of 1934, as amended.

Item 14. ***Controls & Procedures***

Evaluation of Disclosure Controls and Procedures

The Company s Chief Executive Officer (our principal executive officer and principal financial officer) has concluded, based on his evaluation as of a date within 90 days prior to the filing date of this report, that the Company s disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in its reports filed or submitted under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company s management, including the Chief Executive Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Controls

There were no significant changes in the Company s internal controls or in other factors that could significantly affect these controls subsequent to the date of such evaluation.

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SIGNATURES

In accordance with the requirements of section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TEAM SPORTS ENTERTAINMENT, INC.

By:

/s/ CHARLES J. BRADSHAW

Charles J. Bradshaw

Chief Executive Officer and Director

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Dates
/s/ CHARLES J. BRADSHAW **Charles J. Bradshaw**	Chief Executive Officer and Director (principal executive officer, principal financial officer and principal accounting officer)	April 15, 2003
/s/ TERRY WASHBURN **Terry Washburn**	Director	April 14, 2003
/s/ ROBERT J. WUSSLER **Robert Wussler**	Chairman of Board of Directors	April 15, 2003
/s/ TERRY HANSON **Terry Hanson**	President and Director	April 11, 2003

/s/ CALE YARBOROUGH **Cale Yarborough**	Director	April 14, 2003
/s/ DANNY FORD **Danny Ford**	Director	April 12, 2003
/s/ JAY KLOMPMAKER **Jay Klompmaker**	Director	April 14, 2003

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PRINCIPAL EXECUTIVE AND FINANCIAL OFFICER CERTIFICATION PURSUANT TO

SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Charles Bradshaw, certify that:

1. I have reviewed this annual report on Form 10-KSB of Team Sports Entertainment, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

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

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the Evaluation Date); and

c) presented in this annual report my conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. I have disclosed, based on my most recent evaluation, to the registrant s independent auditors and the audit committee of registrant s board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of my most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 15, 2003

/s/ Charles J. Bradshaw

Charles J. Bradshaw

Chief Executive Officer and Director

(principal executive officer and principal financial officer)

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EXHIBIT INDEX

Exhibit Number	Description
3.1	Certificate of Incorporation for Horizon Capital Corp. dated July 22, 1985.
3.2	Certificate of Amendment of Certificate of Incorporation of Horizon Capital Corp. to change its name to Reconversion Technologies, Inc. dated October 14, 1992.
3.3	Certificate of Amendment of Certificate of Incorporation of Reconversion Technologies, Inc. dated January 29, 1994.
3.4	Certificate of Designation, Preferences, Rights and Limitations of Series A Cumulative Convertible Preferred Stock, $2.75 Par Value of Reconversion Technologies, Inc.
3.5	Certificate of Amendment of Certificate of Incorporation of Reconversion Technologies, Inc. dated January 5, 1998.
3.6	Certificate of Amendment of Certificate of Incorporation of Reconversion Technologies, Inc. dated April 19, 2000.
3.7	Certificate of Ownership and Merger merging Motorsports Merger Corp. Into Logisoft Corp. dated May 11, 2001.
3.8	Certificate of Amendment of Certificate of Incorporation of Team Sports Entertainment, Inc. dated July 31, 2001.
3.9	Amended By-laws of Reconversion Technologies, Inc. (predecessor to the Company) dated January 3, 1994.
4.1	Form of Common Stock Certificate.
4.2	Form of Subscription and Investment Representation Agreement dated May 1, 2001.
4.3	Form of Series A Warrant to Purchase Common Stock of the Company.
4.4	Form of Promissory Note Purchase Agreement dated as of September 1, 2002.
4.5	Form of Senior Secured Convertible Promissory Note dated September 1, 2002 (the Promissory Note).
4.6	Form of Security Agreement dated September 1, 2002 relating to the Promissory Note.
4.7	Form of Modification Agreement (Modification of Maturity Date) dated April 15, 2003 relating to the Promissory Note.
4.8	Form of Modification Agreement (Modification of Maturity Date and Principal Amount) dated April 15, 2003 relating to the Promissory Note.
10.1	Employment Agreement between Team Sports Entertainment, Inc., and William G. Miller effective as of January 1, 2002.

10.2	Employment Agreement between Logisoft Corp. and Robert Wussler dated May 2001.
10.3	Logisoft Corp. (predecessor to Team Sports Entertainment, Inc.) 2000 Stock Option Plan.
10.4	Agreement and Plan of Reorganization by and among Logisoft Corp., Jon Pritchett, M.E. Durschlag, Charles Jeter and William Bradshaw, Robert Stadel, Dan Neppl, Cale Yarborough, Godley Morris Group, LLC, Brian Leahy, Lance Leslie, Richard Clark and Robert Wussler dated May 9, 2001.
10.5	Racing Car Design and Construction Agreement between Riley & Scott Racing, LLC dated October 19, 2001 (the Race Car Agreement).
10.6	Letter Agreement dated March 13, 2003 amending the Race Car Agreement.
10.7	Letter of Understanding between Team Racing Auto Circuit, LLC and Moag and Company dated June 24, 2002.
10.8	Sales Representative Agreement between Team Racing Auto Circuit and Raycom Sports dated April 14, 2003.
10.9	Agreement among Team Racing Auto Circuit, LLC, ESPN, Inc. and ESPN Productions, Inc. dated as of April 7, 2003.
*16.1	Letter from Guest & Company dated December 31, 2002 (incorporated by reference from Exhibit 16.3 to the Current Report on Form 8-K/A dated December 11, 2002.
21.1	Subsidiaries of the Company.
99.1	Team Sports Entertainment, Inc. Risk Factors.
99.2	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.3	Press Release dated April 15, 2003.

* Previously filed.
Management compensation contract, plan or arrangement.

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TEAM SPORTS ENTERTAINMENT, INC.

AND SUBSIDIARY

(A Development Stage Company)

REPORT ON CONSOLIDATED FINANCIAL STATEMENTS

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TEAM SPORTS ENTERTAINMENT, INC. AND SUBSIDIARY

(A Development Stage Company)

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Stockholders

Team Sports Entertainment, Inc.

Huntersville, North Carolina

We have audited the accompanying consolidated balance sheet of Team Sports Entertainment, Inc. and Subsidiary (a development stage company) as of December 31, 2002 and the related consolidated statements of operations, changes in stockholders equity and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Team Sports Entertainment, Inc. and Subsidiary (a development stage company) as of December 31, 2002 and the results of their operations, changes in stockholders equity and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that Team Sports Entertainment, Inc. and Subsidiary (a development stage company) will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, Team Sports Entertainment, Inc. and Subsidiary has not yet commenced operations and its total liabilities and commitments exceed current assets available to fund operations. This raises substantial doubt about Team Sports Entertainment, Inc. and Subsidiary s ability to continue as a going concern. Management s plans in regard to these matters are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Elliott Davis, LLC

March 5, 2003

Columbia, South Carolina

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GUEST & COMPANY, P.C.

7170 S. Braden Ave., Suite 100

Tulsa, OK 74136-6333

Phone: 918-481-5355 Fax: 918-481-5771

Independent Auditor s Report

Board of Directors and Stockholders

Team Sports Entertainment, Inc. and Subsidiary:

We have audited the accompanying consolidated balance sheet of Team Sports Entertainment, Inc. and Subsidiary as of December 31, 2001 and the related consolidated statements of operations, stockholders equity and cash flows for the year ended December 31, 2001, and the period from May 15, 2001 (inception) through December 31, 2001 for its development stage subsidiary. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Team Sports Entertainment, Inc. and Subsidiary at December 31, 2001 and the results of their operations and their cash flows for the year ended December 31, 2001, and the period from May 15, 2001 (inception) through December 31, 2001 for its development stage subsidiary, in conformity with accounting principles generally accepted in the United States of America.

/s/ Guest & Company, P.C.

February 22, 2002

Tulsa, Oklahoma

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TEAM SPORTS ENTERTAINMENT, INC. AND SUBSIDIARY

(A Development Stage Company)

CONSOLIDATED BALANCE SHEET

DECEMBER 31, 2002

ASSETS	
CURRENT ASSETS	
Cash and cash equivalents	$ 650,305
Restricted cash and cash equivalents	150,000
Marketable equity securities trading	13,714
Prepaid expenses and other assets	234,976
Total current assets	1,048,995
PROPERTY AND EQUIPMENT	
Race car designs and manufacturing equipment	1,673,400
Office furniture and computer equipment	154,274
Less accumulated depreciation	(32,755)
Net property and equipment	1,794,919
PRODUCTION CONTRACT PAYMENTS	2,395,781
RESTRICTED CASH AND CASH EQUIVALENTS	100,000
GOODWILL	2,810,627
Total assets	**$ 8,150,322**
LIABILITIES AND STOCKHOLDERS EQUITY	
CURRENT LIABILITIES	
Accounts payable and accrued expenses	$ 240,262
Deferred revenue	100,000
Accrued interest payable	15,133
Convertible promissory note	2,270,000
Total current liabilities	2,625,395
COMMITMENTS AND CONTINGENCIES (Notes 5 and 15)	
STOCKHOLDERS EQUITY	
Preferred stock, $2.75 par value; authorized 2,000,000 shares; no shares issued	
Common stock, $.0001 par value; authorized 500,000,000 shares; issued and outstanding 63,476,312 shares	6,348
Additional paid-in capital	15,798,123
Accumulated deficit	(10,279,544)
Total stockholders equity	5,524,927
Total liabilities and stockholders equity	**$ 8,150,322**

See accompanying notes to consolidated financial statements

which are an integral part of this statement.

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TEAM SPORTS ENTERTAINMENT, INC. AND SUBSIDIARY

(A Development Stage Company)

CONSOLIDATED STATEMENTS OF OPERATIONS

For the years ended December 31, 2002 and 2001 and

From Inception (May 15, 2001) through December 31, 2002

	For the years ended December 31,		From Inception (May 15, 2001)
	2002	**2001**	**through December 31, 2002**
Sales and revenues	$	$ 28,310	$ 28,310
Cost of sales		9,536	9,536
Gross profit		18,774	18,774
Selling, general and administrative	3,468,062	2,518,321	5,986,383
Loss from operations	(3,468,062)	(2,499,547)	(5,967,609)
Other income (expense):			
Interest and other income	16,543	136,600	153,143
Interest expense	(81,433)	(2,032)	(83,465)
Unrealized loss on trading securities	(30,286)	(56,000)	(86,286)
Total other income (expense)	(95,176)	78,568	(16,608)
Loss before income taxes and discontinued operations	(3,563,238)	(2,420,979)	(5,984,217)
Income tax expense (benefit)			
Loss from continuing operations	(3,563,238)	(2,420,979)	(5,984,217)
Discontinued operations loss from operations net of tax effect of $0 for 2002 and 2001		(1,380,770)	
Net loss	**$ (3,563,238)**	**$ (3,801,749)**	**$ (5,984,217)**
Net loss per share, basic and diluted:			
Continuing operations	$ (0.06)	$ (0.05)	$ (0.10)
Discontinued operations		(0.03)	
	$ (0.06)	**(0.08)**	**$ (0.10)**
Weighted average shares outstanding, basic and diluted	**62,603,845**	**50,794,719**	**62,560,091**

See accompanying notes to consolidated financial statements

which are an integral part of these statements.

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TEAM SPORTS ENTERTAINMENT, INC. AND SUBSIDIARY

(A Development Stage Company)

CONSOLIDATED STATEMENTS OF STOCKHOLDER S EQUITY

For the years ended December 31, 2002 and 2001

	Common Stock		Additional	Stock	Accumulated Deficit		
	Shares	Par Value	Paid-in Capital	Subscription Receivable	Accumulated Deficit	(Deficit) Accumulated During the Development Stage	Total
Balances at December 31, 2000	30,958,875	$ 3,096	$ 8,788,899	$ (350,000)	$ (2,914,557)	$	$ 5,527,438
Issuance of common stock for services and compensation	573,000	58	167,717				167,775
Issuance of common stock for cash	31,874,700	3,187	7,241,063				7,244,250
Issuance of common stock to acquire Maxx	11,050,000	1,105	2,761,395				2,762,500
Stock options exercised	11,737	1	741				742
Common stock canceled in exchange for discontinued operations	(12,000,000)	(1,200)	(3,426,091)				(3,427,291)
Net loss					(1,380,770)	(2,420,979)	(3,801,749)
Balances at December 31, 2001	62,468,312	6,247	15,533,724	(350,000)	(4,295,327)	(2,420,979)	8,473,665
Common stock warrants exercised	100,000	10	37,490				37,500
Collection of stock subscription				350,000			350,000
Issuance of common stock for loan origination fees	908,000	91	226,909				227,000
Net loss						(3,563,238)	(3,563,238)
Balances at December 31, 2002	**63,476,312**	**$ 6,348**	**$ 15,798,123**	**$**	**$ (4,295,327)**	**$ (5,984,217)**	**$ 5,524,927**

See accompanying notes to consolidated financial statements which are an integral part of these statements.

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TEAM SPORTS ENTERTAINMENT, INC. AND SUBSIDIARY

(A Development Stage Company)

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31, 2002 and 2001, and

From Inception (May 15, 2001) through December 31, 2002

	For the years ended December 31,		From Inception (May 15, 2001) through December 31, 2002
	2002	2001	
CASH FLOWS FROM OPERATING ACTIVITIES:			
Cash received from customers	$	$ 28,535	$ 28,535
Cash received in advance of sales	100,000		100,000
Cash paid to suppliers and employees	(6,668,134)	(1,512,232)	(8,180,366)
Interest paid	(66,300)	(2,032)	(68,332)
Interest and other cash received	16,543	136,600	153,143
Net cash used for operating activities	(6,617,891)	(1,349,129)	(7,967,020)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Collection of note receivable from officer		226,331	226,331
Proceeds from sale of short-term investments		133,669	133,669
Purchase of car design, etc.		(1,673,400)	(1,673,400)
Purchase of software and equipment	(2,277)	(72,781)	(75,058)
Cash paid in excess of net assets received to acquire Maxx		(45,213)	(45,213)
Net cash used for investing activities	(2,277)	(1,431,394)	(1,433,671)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of convertible promissory notes	2,270,000		2,270,000
Proceeds from sale of common stock		7,244,250	7,244,250
Collection of note receivable		240,000	240,000
Collection of stock subscription receivable	350,000		350,000
Exercise of common stock warrants	37,500		37,500
Repayments of capital lease	(62,771)	(12,925)	(75,696)
Net cash provided by financing activities of continuing operations	2,594,729	7,471,325	10,066,054
Net cash used for financing activities of discontinued operations		(15,058)	(15,058)
Net cash provided by financing activities	2,594,729	7,456,267	10,050,996

Net increase (decrease) in cash	(4,025,439)	4,675,744	650,305
CASH AT BEGINNING OF PERIOD	4,675,744		
CASH AT END OF PERIOD	**$ 650,305**	**$ 4,675,744**	**$ 650,305**

See accompanying notes to consolidated financial statements

which are an integral part of these statements.

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TEAM SPORTS ENTERTAINMENT, INC. AND SUBSIDIARY

(A Development Stage Company)

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31, 2002 and 2001, and

From Inception (May 15, 2001) through December 31, 2002

	For the years ended December 31,		From Inception (May 15, 2001) through
	2002	**2001**	**December 31, 2002**
RECONCILIATION OF NET LOSS TO NET CASH USED FOR OPERATING ACTIVITIES:			
NET LOSS	$ (3,563,238)	$ (3,801,749)	$ (5,984,217)
ADJUSTMENTS TO RECONCILE NET LOSS TO NET CASH USED FOR OPERATING ACTIVITIES:			
Loss from discontinued operations		1,380,770	
Depreciation and amortization	104,091	133,473	237,564
Unrealized loss	30,286	56,000	86,286
Stock issued for services		15,000	15,000
Stock-based compensation		152,775	152,775
Changes in operating assets and liabilities			
Receivables		225	225
Inventory		16,990	16,990
Prepaids	(36,380)	(16,127)	(52,507)
Production contract payments	(2,395,781)		(2,395,781)
Accounts payable and accrued expenses	(622,002)	713,514	91,512
Restricted cash	(250,000)		(250,000)
Deferred revenue	100,000		100,000
Interest payable	15,133		15,133
Net cash used for operating activities	**$ (6,617,891)**	**$ (1,349,129)**	**$ (7,967,020)**
NONCASH INVESTING AND FINANCING ACTIVITIES:			
Issuance of stock for loan origination fees	**$ 227,000**	**$**	**$ 227,000**
Acquisition of equipment through capital lease	**$**	**$ 75,696**	**$ 75,696**
Current assets, excluding cash	$	$ 50,000	$ 50,000
Property and equipment		3,017	3,017
Goodwill		2,932,832	2,932,832
Common stock issued		(2,762,500)	(2,762,500)
Liabilities assumed		(178,136)	(178,136)

Cash paid in excess of net assets received in acquisition of Maxx	**$**	**$ 45,213**	**$ 45,213**

See accompaning notes to consolidated financial statements

which are an integral part of these statements

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TEAM SPORTS ENTERTAINMENT, INC. AND SUBSIDIARY

(A Development Stage Company)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation and basis of presentation

The 2002 consolidated financial statements include the accounts of Team Sports Entertainment, Inc. (Team Sports) and its wholly owned subsidiary, Maxx Motorsports, Inc. (Maxx) and its wholly owned subsidiary, Team Racing Auto Circuit, LLC (TRAC), collectively referred to as the Companies . All significant inter-company balances and transactions have been eliminated in consolidation. Maxx, through its wholly owned subsidiary, TRAC, plans to develop, own, operate and sanction an automotive racing league (the League) designed to provide content for television and tracks while expanding the existing base of racing fans. Accordingly, the operations of the Companies are presented as those of a development stage enterprise, from its inception (May 15, 2001), as prescribed by Statement of Financial Accounting Standards (SFAS) No. 7, *Accounting and Reporting by Development State Enterprises*. The Company follows the AICPA SOP 98-5, *Reporting on the Costs of Start-Up Activities* in accounting for its start-up activities. The operations from business activities classified as discontinued operations in the accompanying consolidated financial statements cover periods prior to May 15, 2001.

Organization and nature of business

Team Sports, a Delaware corporation, is a holding company with one wholly owned subsidiary, Maxx, a South Carolina corporation. Maxx, through its wholly owned subsidiary, TRAC, plans to develop, own, operate, and sanction the League designed to provide content for television and tracks while expanding the existing base of racing fans.

On May 15, 2001, Team Sports changed its name from Logisoft Corporation to Team Sports Entertainment, Inc. On May 15, 2001, Team Sports acquired all of the common stock of Maxx in a tax-free stock exchange for 7,750,000 shares of Team Sports common stock. In addition, as a part of this agreement, Team Sports issued 3,300,000 shares of its common stock in exchange for $450,000 of Maxx s liabilities and consulting fees to third parties in the amount of $375,000 that were instrumental to the transaction. Also on this date, Team Sports completed the sale of its wholly owned subsidiaries, LCP and eStorefronts, who created global and localized Internet solutions for both traditional and pure e-business companies, to a group of its shareholders in exchange for 12,000,000 shares of Team Sports common stock, which were canceled. The operations from these business segments have been classified as discontinued operations in the accompanying consolidated financial statements and cover periods prior to May 15, 2001.

Going concern

The Companies have not established sources of revenues sufficient to fund the development of business, projected operating expenses and commitments for the fiscal year 2003. The Companies do not have finalized agreements with a television network in order to obtain television time, or franchise owners to purchase the teams and run local operations. The Companies continuation as a going concern is dependent upon their ability to raise additional capital to fund projected operating losses in 2003 and working capital needs until race operations commence as planned in 2004. The Companies are currently pursuing additional capital and the extension of current obligations and commitments that management believes would be sufficient to fund operations until the projected sale of teams could be finalized in the fall of 2003 to support operations of the league which are planned to commence in 2004. The sale of teams would mark the completion of the development phase, and

at that time management anticipates sufficient sources of capital from these sales and other sources to fund ongoing operations. There can be no assurances, however, that the Companies will be successful in obtaining sufficient additional capital, extension of current obligations, or buyers for the proposed teams in the proposed time. The accompanying consolidated financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Companies be unable to continue as a going concern.

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NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Cash and cash equivalents

The Companies consider all cash on hand, cash in banks and all highly liquid debt instruments purchased with a maturity of three months or less to be cash and cash equivalents.

Restricted cash and cash equivalents

Cash and cash equivalents are considered restricted if they are unable to be withdrawn without notice or penalty.

Marketable equity securities

Investments are classified into three categories as follows:

- Trading securities reported at fair value with unrealized gains and losses included in earnings.
- Securities available-for-sale reported at fair value with unrealized gains and losses reported in other comprehensive income. At December 31, 2002, the Companies had no securities available-for-sale.
- Held-to-maturity securities reported at amortized cost. At December 31, 2002, the Companies had no held-to-maturity securities.

Property and equipment

Property and equipment are stated at cost. Expenditures for significant renewals and improvements are capitalized. Repairs and maintenance are charged to expense as incurred. Depreciation is computed using a straight-line method for financial purposes and an accelerated method for tax purposes based upon the useful lives of the assets. Depreciation expense for the years ended December 31, 2002 and 2001 were $25,687 and $7,608, respectively.

Race car designs (prototypes) and manufacturing equipment are stated at cost and primarily represent payments made under Phase I of the racing car design and construction as relevant. No depreciation expense has been recorded on race car designs (prototypes) as operations had not commenced as of December 31, 2002 and no race cars were in-process.

In 2002, the Companies paid-off all capital lease as agreements totaling $62,771.

Team Sports reviews quarterly its property and equipment in accordance with SFAS No. 121 *Accounting for the Impairment of Long Lived Assets* to determine if its carrying costs will be recovered from future operating cash flows. In cases where Team Sports does not expect to recover its carrying costs, Team Sports recognizes an impairment loss. As the operations to which the property and equipment relate have not yet commenced, no impairment loss has been recognized.

In August 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived* Assets, which supersedes prior pronouncements associated with impairment or disposal of long-lived assets. The statement establishes methodologies for assessing impairment of long-lived assets, including assets to be disposed of by sale or by other means. The adoption of this standard had no impact on the financial position of the Companies.

Production contract payments

Production contract payments consist of payments made to Riley & Scott Race Car Engineering which are to be used to purchase parts, engines, and for the production of race cars. All production contract payments consist of payments made under Phase II (see Note 5) of the Racing Car Design and Construction Agreement.

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NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Goodwill

SFAS No. 142, *Goodwill and Other Intangible Assets* has been applied to the Maxx transaction. Accordingly, goodwill is not amortized but reviewed for impairment at least annually or more frequently if impairment indicators arise. Using the estimated undiscounted cash flows approach, the Company has not recorded an impairment to goodwill as of December 31, 2002, as the operations to which the goodwill relates have not yet commenced. The amortization of goodwill prior to the adoption of SFAS No. 142 was suspended as of December 31, 2001. Goodwill of $2,810,627, net of accumulated amortization of $122,205 through December 31, 2001, has been amortized on a straight-line basis over 15 years. The net loss reported for 2001 adjusted to exclude goodwill amortization expense which is no longer required under SFAS No. 142 would have been $3,679,544 with an associated basic and diluted total net loss per share of $0.07.

Revenue recognition

Revenue from product sales is recognized when the related goods are shipped and all significant obligations have been satisfied. Revenue from services is recognized when the services are performed.

Stock option plans

Team Sports applies the intrinsic value-based method of accounting prescribed by Accounting Principles Board Opinion No. 25 (APB No. 25), *Accounting for Stock Issued to Employees*, and related interpretations, in accounting for its stock option plan. As such, compensation expense would be recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price.

SFAS No. 123, *Accounting for Stock Based Compensation* (SFAS No. 123), requires the Company to disclose pro forma information regarding option grants made to its employees. SFAS No. 123 specifies certain valuation techniques that produce estimated compensation charges that are included in the pro forma results below. These amounts have not been reflected in the Company s consolidated statement of operations, because APB No. 25 specifies that no compensation charge arises when the price of the employees stock options equal the market value of the underlying stock at the grant date, as in the case of options granted to Team Sports employees, board of directors, advisory committee members, and consultants.

SFAS No. 123 pro forma numbers are as follows for the years ended December 31, 2002 and 2001:

	2002	2001	From Inception
Net loss, as reported	$ 3,563,238	$ 3,801,749	$ 5,984,217
Add: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	512,946	2,923,596	3,436,542
Pro forma net loss	**$ 4,076,184**	**$ 6,725,345**	**$ 9,420,759**

Pro forma basic and diluted total net loss per share	$ 0.07	$ 0.11	$ 0.15
Basic and diluted total net loss per share as reported	$ 0.06	$ 0.08	$ 010

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NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Stock option plans, continued

Under SFAS No. 123, the fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. At December 31, 2001, the year in which all options were issued, the following weighted average assumptions were used: risk-free interest rate based on date of issuance and term between 3.83% and 4.93%, no expected dividends, a volatility factor of 138.13% and an expected life of the options of 3 to 10 years. Using these assumptions, the total value of stock options and rights to receive stock granted in 2001 was $6,111,858.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because Team Sports employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management s opinion the existing models do not necessarily provide a reliable single measure of the fair value of Team Sports options.

Deferred income taxes

Deferred income taxes are provided for temporary differences between financial and tax reporting in accordance with the liability method under the provisions of SFAS No. 109, *Accounting for Income Taxes*. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless management believes it is more likely than not that such assets will be realized.

Earnings (loss) per common share

Earnings (loss) per common share are calculated under the provisions of SFAS No. 128, *Earnings per Share*, which established new standards for computing and presenting earnings per share. SFAS No. 128 requires Team Sports to report both basic earnings per share, which is based on the weighted-average number of common shares outstanding, and diluted earnings per share, which is based on the weighted-average number of common shares outstanding plus all potential dilutive shares outstanding.

Estimates

The preparation of consolidated 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 disclosure 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.

Recent accounting pronouncements

The following is a summary of recent authoritative pronouncements that affect accounting, reporting, and disclosure of financial information by the Company.

In June 2001, the FASB issued SFAS No. 141, *Business Combinations*, and SFAS No. 142, *Goodwill and Other Intangible Assets*. SFAS No. 141 addresses financial accounting and reporting for business combinations and supersedes APB Opinion No. 16, *Business Combinations*, and SFAS No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises*. All business combinations in the scope of SFAS No.141 apply to all business combinations initiated after June 30, 2001 of for which the date of acquisition is July 1, 2001, or later. The adoption of this standard has no impact on the results of operations or financial position of the Company.

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NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Recent accounting pronouncements, continued

SFAS No. 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APF Opinion No. 17, *Intangible Assets*. It addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. This Statement also addressed how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. The provisions of this Statement are required to be applied starting with fiscal years beginning after December 15, 2001. Early application is permitted for entities with fiscal years beginning after March 15, 2001, provided that the first interim financial statements have not previously been issued. This Statement is required to be applied at the beginning of an entity s fiscal year and to be applied to all goodwill and other intangible assets recognized in its financial statements at that date. Impairment losses for goodwill and indefinite-lived intangible assets that arise due to the initial application of this Statement (resulting from a transitional impairment test) are to be reported as resulting from a change in accounting principle. The Companies adopted this Statement on January 1, 2002 and did not record an impairment loss as a result of the initial application of this Statement.

In April 2002, The FASB issued SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections.* This statement rescinds SFAS No. 4, *Reporting Gains and Losses from Extinguishments of Debt* and SFAS No. 64, *Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements.* This statement also rescinds SFAS No. 44, *Accounting for Intangible Assets of Motor Carriers* and amends SFAS No. 13, *Accounting for Leases.* This new statement requires gains and losses from extinguishment of debt to be classified as an extraordinary item only if they meet the criteria of APB Opinion No. 30, *Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, which will distinguish transactions that are part of an entity s recurring operations from those that are unusual or infrequent or that meet the criteria for classification as an extraordinary item. The adoption of the provisions of SFAS No. 145 had no impact on the Company s financial position or results of operations.

In June 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, which addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring).* This Statement applies to costs associated with specific exit activities and requires a liability for a cost associated with an exit or disposal activity to be recognized and measured initially at its fair value in the period in which the liability is incurred. A liability for a cost associated with an exit or disposal activity is incurred when the definition of a liability is met. The provisions of this statement are effective for exit or disposal activities that are initiated after December 31, 2002. The provisions of this statement were adopted by the Company on January 1, 2003 with no anticipated material impact on financial position or results of operations.

In December 2002, the FASB issued SFAS No. 148 *Accounting for Stock-Based Compensation Transition and Disclosure* an amendment of FASB Statement No. 123. This Statement amends FASB Statement No. 123, *Accounting for Stock-Based Compensation*, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of Statement No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company adopted this standard effective December 31, 2002 and has included the required disclosures in the notes to the consolidated financial statements. The Company has not elected the fair value treatment of stock-based compensation and the adoption of this standard has no impact on its financial position.

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NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Recent accounting pronouncements, continued

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the consolidated financial statements upon adoption.

Fair value determination

Financial instruments consist of cash, marketable securities, promissory notes receivable, accounts payable, accrued expenses and short-term borrowings. The carrying amount of these financial instruments approximates fair value due to their short-term nature or the current rates at which the company could borrow funds with similar remaining maturities.

Advertising costs

Team Sports expenses advertising costs as incurred. Team Sports recorded advertising costs of $175,225 and $284,857, respectively, for the years ended December 31, 2002 and 2001.

Compensated absences

Team Sports accounts for compensated absences in accordance with SFAS No. 43, *Accounting for Compensated Absences*.

Reclassifications

Certain prior year amounts have been reclassified to conform with current year presentation.

NOTE 2 ACQUISITION OF MAXX MOTORSPORTS, INC.

On May 15, 2001 Team Sports acquired all of the common stock of Maxx in a tax-free stock exchange for 7,750,000 shares of Team Sports common stock. In addition, as a part of this agreement, Team Sports issued 3,300,000 shares of its common stock in exchange for $450,000 of Maxx s liabilities and consulting fees to third parties of $375,000 that were instrumental to the transaction. Team Sports valued the 11,050,000 shares, which are restricted securities and may be sold only in compliance with Rule 144 of the Securities & Exchange Act, issued at $.25 per share near this same date.

TRAC will initially consist of multi-car teams, strategically positioned in major North American television markets located near major motorsport venues. Each team will represent the city or state where it is located. The initial TRAC racing season, planned to start in 2004, will consist of a regular season race schedule, an all-star race and a Championship Race. TRAC will incorporate the use of aerodynamically similar

cars, fuel-injection engines and other innovative competition standards to increase parity among the teams without diminishing the entertainment value.

TRAC intends to initially enter into operating agreements with up to six third parties (the Local Operators) to be identified by TRAC with respect to the local operations of a TRAC racing team, but reserves the right to operate one or more teams itself. Each Local Operator will pay a fee to TRAC to obtain the right to operate the team in its market. TRAC expects to generate revenues from national television, radio and other media agreements (including rights fees and/or revenue sharing from sales of advertising time), sales of national corporate sponsorships for the League and for League events (such as the Championship Race), sales of sponsorships of the teams, ticket sales, parking and concession revenue for the races, license fees from sales of officially licensed merchandise and expansion fees. In addition to the rights fee payable to TRAC, TRAC expects to require each Local Operator to bear all local expenses of operating team, including the costs of all personnel (other than drivers) necessary to operate the team; drivers will be employees of TRAC and assigned to the teams. The rights to all local and national revenues will be owned by TRAC but the Local Operators will be entitled to retain all or a significant portion of certain local revenues (e.g. local ticket sales, parking and concession revenue and local sponsorships) and to share in certain national revenues (e.g. television and radio licensing fees, national sponsorship and merchandise licensing revenue) and in any expansion fees paid to TRAC.

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NOTE 2 ACQUISITION OF MAXX MOTORSPORTS, INC., Continued

The acquisition of Maxx has been accounted for using the purchase method of accounting. Accordingly, the net assets acquired were recorded at fair value at the date of the acquisition. The transaction resulted in goodwill in the amount of $2,932,832, which was amortized over fifteen years through December 31, 2001. A summary of the assets acquired and liabilities assumed in the acquisition follows:

Current assets, excluding cash	$	50,000
Property and equipment		3,017
Goodwill		2,932,832
Common stock issued		(2,762,500)
Liabilities assumed		(178,136)
Cash paid in excess of net assets received	**$**	**45,213**

Pro forma results of operations from continuing operations for the year ended December 31, 2001, as if the acquisition had occurred at the beginning of the periods follows:

		2001
Revenues	**$**	**28,310**
Loss from operations	**$**	**(2,547,325)**
Basic and Diluted net loss per share	**$**	**(.05)**

NOTE 3 MARKETABLE EQUITY SECURITIES TRADING

The cost of investment securities as shown in the accompanying consolidated balance sheet and their estimated market value at December 31, 2002 is as follows:

Trading securities cost	$	100,000
Unrealized loss		(86,286)
	$	**13,714**

Team Sports has classified these securities as trading securities and has included an unrealized loss in the amount of $30,286 and $56,000 in earnings for the years ended December 31, 2002 and 2001, respectively. This investment represents 28,571 shares of eResource Capital Group. At December 31, 2002, eResource Capital Group was the beneficial owner of 332,000 shares of Team Sports stock.

NOTE 4 NOTES RECEIVABLE OFFICER

In July 2000, Team Sports entered into a bridge loan with the former Chief Executive Officer of the company related to the purchase of the officer s principal residence. The remaining balance of this loan in the amount of $226,311, plus accrued interest was repaid in full by April 2001.

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NOTE 5 PRODUCTION CONTRACT PAYMENTS AND COMMITMENTS

On October 22, 2001, TRAC entered into a Racing Car Design and Construction Agreement with Riley & Scott Race Car Engineering. The agreement required payments aggregating $1,515,000 during Phase I, which was 23 weeks, and included design, tooling, prototype construction and aero tooling. Phase II of the agreement commenced after completion of Phase I and was planned to be completed in 58 weeks. Phase II was based upon production of 100 racing cars, at a cost of approximately $110,000 each, plus the cost of engines. The agreement also provides for the contractor to be the sole provider of most repair service. Phase I of the agreement was completed during March 2002 and Phase II of the agreement commenced in April 2002. In August 2002, TRAC and Riley & Scott agreed upon a revised schedule based on the delay of the initial race season to 2004. This revised schedule required a $500,000 payment prior to August 31, 2002 and subsequent monthly payments of $50,000 through April 2003. Phase II of the agreement will not continue until a new production schedule has been agreed to by both Team Sports and Riley & Scott. This is scheduled to be determined after the final $50,000 payment is made in April 2003. At December 31, 2002, the Company had incurred and paid total costs of $2,395,781, which amount is included in production contract payments.

Upon termination of the agreement, Riley & Scott shall have all rights and title to all Racing Cars, components, vendored components and Spares (Post Termination Inventory) then in its possession. Riley & Scott may sell all or part of the post termination inventory in any arms length transaction in a bona fide transaction to the buyer offering the highest price. In the event that the amount realized in any such sale is less than the total amount due as of the termination date, Riley & Scott shall be entitled to money damages equal to the difference between the net proceeds of the sale and the full amount due as of the termination date plus penalties to include attorney s fees, interest on delinquent amounts, storage fees, insurance, broker s fees, and advertising expenses. In the event that the sales price of the post termination inventory exceeds Riley & Scott s cost and penalties, Team Sports would receive 75% of the excess.

NOTE 6 INCOME TAXES

Team Sports has not recorded a deferred tax benefit or expense for the years ended December 31, 2002 and 2001, as all net deferred benefits have a full valuation allowance.

Actual income tax expense applicable to earnings before discontinued operations and income taxes is reconciled with the normally expected federal income tax as follows:

	2002	2001
Normally expected income tax benefit	$ 1,329,087	$ 823,133
Increase (decrease in taxes resulting from:		
Nondeductible meals and entertainment	(2,600)	(1,278)
Valuation allowance	(1,326,487)	(821,855)
Actual income tax expense	$	$

The change in the valuation allowance attributed to discontinued operations has not been reflected in the reconciliation above.

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NOTE 6 INCOME TAXES, Continued

The net deferred taxes at December 31, 2002 are comprised of the following:

Marketable securities unrealized loss	$	32,185
Valuation allowance on assets		(32,185)
Deferred tax assets current		
Net operating carryforward		11,340,954
Start-up costs		675,466
Valuation allowance on assets		12,016,420
Deferred tax assets noncurrent		(12,016,420)
Net deferred tax asset	**$**	

Team Sports has available unused net operating loss carryforwards of $30,404,702 which will expire in various periods from 2007 to 2022, some of which may be limited as to the amount available on an annual basis.

NOTE 7 CONVERTIBLE PROMISSORY NOTES

From August 16, 2002 through October 15, 2002, Team Sports issued $2,270,000 in convertible promissory notes to certain stockholders of the Company. The notes bear interest at 8% per annum, require quarterly interest payments, and mature August 31, 2003. Each note is convertible into Team Sports common stock at the rate of $.20 per share. A 10% loan origination fee was paid through the issuance of 908,000 common shares to the stockholders at $.25 per share. The loan origination fee of $227,000 is being amortized over the term of the convertible promissory notes and is included on the balance sheet as another asset net of accumulated amortization of $78,404. The notes are collateralized by all the assets of the Company. The common stock issued for the origination fees and the common stock issuable upon conversion of the convertible notes payable is restricted and may only be sold in compliance with Rule 144 of the Securities and Exchange Act.

NOTE 8 LEASES

TRAC leases property under a noncancelable operating lease. The operating lease consists of office space that will expire over the next four years.

Future minimum lease payments under the noncancelable operating lease as of December 31, 2002 are as follows:

Years ended	**Operating leases**
2003	123,462
2004	126,368
2005	129,273
2006	65,363
Total minimum lease payments	**$ 444,466**

Team Sports recognized rent expense for leased facilities of $119,145 and $136,512 in 2002 and 2001, respectively.

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NOTE 9 COMMON STOCK OPTIONS AND WARRANTS

In April 2000, Team Sports adopted its 2000 Stock Option Plan (the Plan) and the company s Board of Directors approved the same. Team Sports shareholders approved the Plan in April 2001. The Plan was established to advance the interests of Team Sports and its stockholders by attracting, retaining and motivating key personnel. The Board of Directors, or a committee that it appoints, is authorized to grant options to purchase the common stock of Team Sports, not to exceed an aggregate of 3,000,000 shares. The Board of Directors, or a committee that it appoints, is also authorized to establish the exercise price and vesting terms of individual grants under the Plan. In 2001, the Board of Directors approved a proposal to increase the number of authorized shares available under the Plan not to exceed an aggregate of 7,500,000 shares.

Options granted under the Plan may be either incentive stock options intended to qualify as such under the Internal Revenue Code, or non-qualified stock options. Team Sports expects that most options granted pursuant to the Plan will be subject to vesting over a three or four-year period, such as 25% increments on each annual grant date anniversary, during which the optionee must continue to be an employee of Team Sports. The Board or the committee, if applicable, may choose to impose different vesting requirements or none at all. Options outstanding under the Plan have a maximum term of up to ten (10) years.

The Plan also provides that all options that are not vested will become vested upon a change in control, unless the options are either assumed or substituted with equivalent options. In addition, unvested options become vested, after a change in control, if an optionee is subject to involuntary termination other than for cause during that optionee s remaining vesting period after a change in control. The Plan further provides that all options will be forfeited 90 days after employment terminates. All options granted under the Plan in 2000 were to employees and consultants of LCP and eStorefronts, which were sold on May 15, 2001. Options to acquire 11,737 shares of Team Sports common stock were exercised during 2001 and the remaining 1,806,463 were forfeited on August 13, 2001. Options to acquire 116,250 shares had previously been forfeited.

In May 2001, Team Sports granted common stock options under the Plan to three employees as part of their employment contracts for a total of 1,000,000 shares of its common stock at an exercise price of $1.00 per share, which was above the market price at the time. Accordingly, no additional compensation expense was recorded, pursuant to APB No. 25. The options vest as follows:

	Shares
September 30, 2001	83,333
December 31, 2001	333,332
June 30, 2002	333,334
June 30, 2003	250,001
	$ 1,000,000

The options can vest sooner if certain performance criteria are met.

In December 2001, Team Sports granted common stock options to its seven Advisory Board members for a total of 1,750,000 shares of its common stock at an exercise price of $1.00 per share, which was above the market price at the time. These options have a 5-year life and are exercisable immediately. In addition, Team Sports granted common stock options to its eight Board members for a total of 4,000,000 shares of its common stock, also exercisable at $1.00 per share, with a 10-year life and are exercisable immediately. These 5,750,000 options were all granted under the Plan.

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NOTE 9 COMMON STOCK OPTIONS AND WARRANTS, Continued

A summary of stock option activity under the Plan during the years ended December 31, 2002 and 2001 is as follows:

	2002		2001	
	Shares	**Weighted average exercise price**	**Shares**	**Weighted average exercise price**
Outstanding, beginning of year	6,900,000	$ 0.99	1,823,450	$ 1.30
Granted			7,011,000	0.98
Exercised			(11,737)	0.06
Forfeited	(500,000)	1.00	(1,922,713)	1.21
Outstanding, end of year	6,400,000	0.99	6,900,000	0.99
Options exercisable at year-end	6,316,665	0.99	6,316,665	0.99
Weighted average fair value of options granted during the year	$		$ 0.98	
Shares available for grant	1,100,000		600,000	

Team Sports applies APB No. 25 and related interpretations in accounting for the stock option plan. In 2001, stock compensation expense has been recorded for 35,000 options issued to two employees with an exercise price of $0.01 per share. Compensation expense is being recognized for the difference between the fair value of the shares on the day the options were granted and the $0.01 exercise price, over the related service period of one year. Team Sports recognized $0 and $16,787 of stock compensation expense for the years ended December 31, 2002 and 2001, respectively, relating to these options. The remaining stock compensation expense of $4,737 in 2001, relates to stock options granted to individuals for services performed.

As a part of its issue of 28,977,000 shares of its common stock on May 15, 2001 for $7,244,250 in cash, Team Sports also issued warrants to purchase 14,488,500 shares of its common stock at a purchase price of $1.00 per share. These warrants expire three (3) years from the effective date of the Securities and Exchange Commission registration of the 28,977,000 shares of common stock.

In February of 2000, Team Sports issued 100,000 warrants which were exercisable at $.375 per share and expired in February of 2003. Each warrant was for 1 share of Team Sports common stock and the warrants were not part of the acquisition of Maxx Motorsports. These warrants were exercised in March of 2002.

Three investors exercised 350,000 Class A warrants prior to their expiration on June 7, 2002, and executed non-interest bearing promissory notes for $350,000 which were originally due December 9, 2000. In November 2000, Team Sports   Board of Directors extended the due date of these notes until December 9, 2001. These notes were received in April of 2002.

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NOTE 10 COMMON STOCK

On June 21, 2001, a majority of the shareholders of Team Sports, through written consent, approved the increase in authorized common stock of Team Sports from 60,000,000 shares, par value $.0001 to 500,000,000 shares, par value $.0001. The increase was filed August 6, 2001 with the state of Delaware.

In 2001, Team Sports sold, pursuant to agreements, 28,977,000 shares of its common stock for $7,244,250. The agreements required Team Sports to prepare and file with the SEC, within 75 days of the acquisition of Maxx (May 15, 2001), a registration statement covering these securities for an offering to be made on a continuous basis pursuant to Rule 415 of the U.S. Securities and Exchange Act. As a result of delays in obtaining certain information from outside parties that was necessary to complete the registration, the registration statement was filed after the end of the 75 day period. In accordance with the terms of the agreements, Team Sports was required to issue an additional 2,897,700 common shares effective May 15, 2001. These 31,874,700 shares are restricted securities and may be sold only in compliance with Rule 144 of the Securities and Exchange Act.

Preferred Stock The Company is authorized to issue up to 2,000,000 shares of Series A non-voting, cumulative preferred stock with a par value of $2.75. At December 31, 2002, no preferred stock was issued or outstanding.

A 6% cumulative dividend is payable quarterly to stockholders of record on the last day of the month prior to the dividend date. The Series A preferred stock has a liquidation preference over Team Sports common stock as well as any other classes of stock established by Team Sports.

NOTE 11 EARNINGS (LOSS) PER SHARE

At December 31, 2002, all exercisable common stock equivalents were antidilutive and are not included in the earnings (loss) per share calculations.

NOTE 12 LETTER OF CREDIT

A letter of credit was purchased guaranteeing the Companies performance or payment to a third party. At December 31, 2002, TRAC had an outstanding letter of credit in the amount of $150,000 for use as partial security for an office lease. The letter of credit is currently secured by cash deposit. In order to obtain the letter of credit, the Companies were required to place $150,000 with a financial institution to collateralize the letter of credit. The letter of credit amount will decrease $50,000 upon the third renewal of the operating lease in 2003 and is included as a current asset on the Companies balance sheet. The remaining balance required to secure the letter of credit, $100,000, is included as a noncurrent asset as it will be required to collateralize the $100,000 letter of credit requirement for 2004 and thereafter.

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NOTE 13 DISCONTINUED OPERATIONS

As a part of the acquisition of Maxx, Team Sports was required to sell its interest in its wholly owned subsidiaries, LCP and eStorefronts, to a group of its shareholders for 12,000,000 shares of its common stock. Accordingly, no gain or loss was recognized on the transaction, which was completed on May 15, 2001. Operating results for the discontinued operations for the year ended December 31, 2001, was as follows:

	2001
Net sales	**$ 2,532,207**
Loss before income taxes	$ (1,380,770)
Income taxes	
Net loss from discontinued operations	**$ (1,380,770)**

NOTE 14 RELATED PARTY TRANSACTIONS

In 2002 and 2001, the Companies had various transactions with related parties, primarily its board members and officers. The following is a summary of those transactions:

	2002	2001
Payable to officers and board members	$ 105,493	$ 221,020
Consulting expenses	219,501	127,083
Lease settlement to board member		90,000
Stock issued for services		167,775
Directors fees	70,500	29,250
Legal fees	85,684	
Reimbursed aircraft expense	78,929	

Team Sports had an employment agreement with its former Chief Executive Officer (CEO). This agreement combined a base pay amount of $50,000 per month, with $200,000 paid for consulting services from September 1, 2001 through December 31, 2001 and $300,000 paid for services from January 1, 2002 through June 30, 2002. In addition, the Companies obtained restricted certificates of deposit in the amount of $480,000 to be paid if the CEO was employed at July 1, 2002 for compensation through April 30, 2003. This entire amount was paid to the former CEO prior to the termination of his employment on August 8, 2002. The former CEO also received stock options to purchase 3,000,000 shares of Team Sports common stock, of which 2,500,000 shares vested upon execution of the agreement and the remaining 500,000 shares vested when the former CEO was accepted to the Board of Directors in 2002. The stock option to acquire 2,500,000 shares is not granted under the 2000 stock option plan described in Note 7 to these consolidated financial statements.

On August 25, 2001, Team Sports entered into an agreement in principle with its former Chief Executive Officer under which the Chief Executive Officer will become the local operator of a market. The agreement states that the cost will be $100,000 which is included in restricted cash on the balance sheet herein, plus the cost of the nine racing cars and three haulers to obtain the operating rights for the team, which is substantially less than amounts anticipated to be paid by other local operators.

In 2001, Team Sports granted common stock options to the Chairman of the Board of Directors for a total of 1,000,000 shares of its common stock at an exercise price of $.375 per share, which was above the market price at the time (based upon common stock sales for cash near the same date). These options were exercisable immediately and have a 3-year life. These stock options were not granted under the 2000 Stock Option Plan.

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NOTE 15 CONTINGENCIES

In the normal course of business, the Companies may be involved in legal actions and claims. In management s opinion, after consideration of available insurance coverage and other matters, litigation is not expected to have a material adverse effect on the Companies financial position.